TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 467

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SYLVIE R. GRIFFITHS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 20, 1942
CERTIORARI GRANTED NOVEMBER 23, 1942

SUPREME COURT OF THE UNITED STATES

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1 Before United State Board of Tax Appeals

Docket No. 110035

SYLVIE R. GRIFFITHS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Will R. Gregg, Esq. Allin H. Pierce, Esq.

Docket entries

1942

Feb. 26—Petition received and filed. Taxpayer notified. (Fee paid.)

Feb. 27—Copy of petition served on General Counsel.

Mar. 3—Answer filed by General Counsel.

Mar. 3—Notice for submission under Rule 30 filed.

Mar. 3—Notice issued placing proceeding on New York, N. Y., Calendar. Answer served.

Mar. 3—Order of assignment to Division No. 10 (Sternhagen), for report, entered.

Mar. 3—Memorandum opinion rendered, Sternhagen, Div. 10. Decision will be entered for the petitioner. 3/4/42 copy served.

Mar. 3—Decision entered, Sternhagen, Div. 10.

May 14—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by General Counsel.

May 21—Proof of service filed.

May 21—Praecipe for record filed by General Counsel—with proof of service thereon.

3 Before United States Board of Tax Appeals

Docket No. 110035

SYLVIE R. GRIFFITHS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed Feb. 26, 1942

The above-named petitioner, whose name formerly was Sylvie L. Redmond, hereby petitions for a redetermination of the

deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated December 8, 1941, and as a basis of her proceeding alleges as follows:

1. The petitioner is an individual whose name prior to her marriage was Sylvie L. Redmond; and she is the taxpayer who is designated by the latter name in the said notice of deficiency. Her principal residence during the period here involved was in New York, New York, and her address for federal income-tax purposes is care of Carter, Ledyard & Milburn, 2 Wall Street, New York, New York. Her federal income-tax return for the period here involved was filed with the Collector of Internal Revenue for the Second District of New York.

2. The notice of deficiency (a copy of which is attached and marked "Exhibit A") was mailed to the petitioner on December 8, 1941.

3. The taxes in controversy are income taxes for the calendar year 1939 and in the amount of $9.60.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

First Assignment of Error

The respondent erred in including in the petitioner's gross income the amount of $120.16 which, it is stated in the notice of deficiency, represents the fair market value of 2½ shares of common stock of Standard Oil Company (New Jersey) received by petitioner in 1939 as a dividend on 100 shares of common stock held by her in that corporation.

Second Assignment of Error

The respondent erred in failing to determine that the additional shares of the capital stock of Standard Oil Company (New Jersey) which the petitioner received in 1939 as stock dividends on shares of the capital stock of that corporation held by her did not constitute income to her within the meaning of the Sixteenth Amendment to the Constitution of the United States.

Third Assignment of Error

In the alternative, if any amount is includible in the petitioner's gross income in respect of the additional shares of the capital stock of Standard Oil Company (New Jersey) which she received as stock dividends, the respondent erred in determining that such amount was $120.16.

5. The facts upon which the petitioner relies as the basis of this proceeding are, upon information and belief, as follows:

(a) Standard Oil Company (New Jersey) is a corporation organized and existing under the laws of the State of New Jersey. Throughout the year 1939 its total authorized capital stock was $750,000,000 divided into 30,000,000 shares of the par value of $25 each, of which there were issued and outstanding on January 1, 1939, approximately 26,500,000 shares of the aggregate par value of approximately $662,500,000. In addition, the corporation had on January 1, 1939, a capital surplus per books of approximately $66,500,000 and earned surplus and undivided profits per books of approximately $130,000,000. The amounts represented by said outstanding capital stock, capital surplus, earned surplus, and undivided profits were invested in assets or otherwise used by the corporation for the purposes of its business.

(b) All of the shares of the capital stock of said corporation which were outstanding at any time during the year 1939 were of the same class and character; and the rights and interest of the holder of each share thereof were identical with those of the holder of every other share.

(c) On May 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two (2) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

(d) On November 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on December 15, 1939, there be distributed to the

stockholders of record at the close of business on November 15, 1939, additional shares of the capital stock of the corporation on the basis of three (3) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

(e) The additional shares of the capital stock of Standard Oil Company (New Jersey) so distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance, the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former interest. In neither instance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of the additional shares of the capital stock issued and distributed.

(f) On May 16, 1939, and continuously to the time of the distribution of said stock dividend on June 15, 1939, the petitioner was the owner and holder of 101 shares of the capital stock of Standard Oil Company (New Jersey) of which her total adjusted cost basis for computing gain or loss for federal income tax purposes was $5,750.36. On June 15, 1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.01 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on June 15, 1939, immediately after the receipt of said additional shares by the petitioner, was $42.50; and the fair market value at that time of the 102.01 shares then held by the petitioner was $4,335.43, including the fair market value of said 1.01 additional shares which was $42.93.

(g) The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.01 additional shares was $25.25; and the amount transferred from its earned surplus account to its capital surplus account in connection with the issuance of said shares was $2.525.

(h) From June 15, 1939, to the time of the distribution of the said stock dividend on December 15, 1939, the petitioner was the owner and holder of 102.01 shares of the capital stock of Standard Oil Company (New Jersey). On December 15, 1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.53 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on December 15, 1939, immediately after the receipt of said additional shares by the petitioner was $43.1875; and the fair market value at that time of the 103.54 shares then held by the petitioner was $4,471.63, including the fair market value of said 1.53 additional shares which was $66.08.

(i) The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.53 additional shares was $38.25; and the amount transferred from its earned surplus account to its capital surplus account in connection with the issuance of said shares was $3.825.

(j) None of said additional shares of the capital stock of Standard Oil Company (New Jersey) received by the
7 petitioner as stock dividends have been cancelled or redeemed by the corporation. None of said shares were sold by the petitioner during the taxable year here involved.

(k) In her federal income tax return for 1939, the petitioner did not include in her gross income any amount in respect of the additional shares of the capital stock of Standard Oil Company (New Jersey) which she received as stock dividends on June 15, 1939, and December 15, 1939, respectively.

(l) At all times here material, the petitioner kept her books of account and made her federal income tax returns in accordance with the cash receipts and disbursements method of accounting and on the calendar year basis.

Wherefore, the petitioner prays that this Board may hear the proceeding, may conclude that no amount is includible in her gross income by reason of her receipt of said stock dividends, and may determine that there is no deficiency in respect of her income tax liability for the year 1939; or, in the alternative, petitioner prays that, if any amount is includible in her gross income by reason of her receipt of said stock dividends, this Board may

determine the correct amount to be included and also the correct amount of her income tax liability for the taxable year involved.

WILL R. GREGG,
Will R. Gregg,
ALLIN H. PIERCE,
Allin H. Pierce,
Counsel for Petitioner,
2 Wall Street, New York, New York.

[*Duly sworn to by Sylvie R. Griffiths; jurat omitted in printing.*]

8 *Exhibit "A" to petition*

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Dec. 8, 1941.

Office of Internal Revenue Agent in Charge, Second New York Division. SN-IT-1.

Miss SYLVIE L. REDMOND,
c/o Carter, Ledyard & Milburn,
Two Wall Street, New York, New York.

MADAM: You are advised that the determination of your income tax liability for the taxable year ended Dec. 31, 1939, discloses a deficiency of $9.60 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Revenue Agent in Charge, Rm. 1200, 225 Broadway, N. Y., N. Y., for the attention of LAL-90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By C. R. KRIGBAUM,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.

Statement

Miss Sylvie L. Redmond, c/o Carter, Ledyard & Milburn, Two Wall Street, New York, New York

Tax Liability for Taxable Year Ended December 31, 1939

	Liability	Assessed	Deficiency
Income tax	$279.81	$270.21	$9.60

9 In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 21, 1941.

Adjustment to Net Income

Net income as disclosed by return	$6,659.38
Unallowable deduction and additional income:	
(a) Dividends	120.16
Net income adjusted	$6,779.54

Explanation of Adjustment

(a) The additional dividends represent the fair market value of 2½ shares of common stock of Standard Oil Company (New Jersey) received by you in 1939 as a dividend on 100 shares of common stock held by you in that corporation.

Computation of Tax

Internal Revenue Code

Tax liability for Taxable Year Ended December 31, 1939

Net income as adjusted		$6,779.54
Less: Personal exemption		1,000.00
Balance (surtax net income)		$5,779.54
Less: Interest on Government obligations	$13.75	
Earned income credit	300.00	
		313.75
Net income subject to normal tax		$5,465.79
Normal tax at 4% on $5,465.79		$218.63
Surtax on $5,779.54		71.18
Total tax		$289.81
Less: Income tax paid at the source		10.00
Correct income tax liability		$279.81
Income tax assessed:		
Original, Account No. 820835		270.21
Deficiency of income tax		$9.60

10 Before United States Board of Tax Appeals

[Title omitted.]

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, and for his answer to the petition filed herein admits and denies as follows, to wit:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged in the first, second and third assignments of error as set forth in Paragraph 4 of the petition.

5. Admits the allegations contained in subparagraphs (a), (b), (c), (d), (e), (f), (g), (h), (i), (j), (k), and (l) of Paragraph 5 of the petition.

Wherefore, it is prayed that the respondent's determination be approved.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
M. B. LEESING,
Assistant Chief Counsel.
S. T. HAZARD,
Special Attorney,
Bureau of Internal Revenue.

11 Before United States Board of Tax Appeals

Docket No. 110035

SYLVIE R. GRIFFITHS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Memorandum Opinion

STEENHAGEN: This proceeding assails a determination of a deficiency of $9.60 in petitioner's income tax for 1939. It is

submitted upon the pleadings under Rule 30. The facts alleged in the petition are all admitted in the answer.

The Commissioner determined that stock dividends of common shares received by the petitioner in the taxable year upon shares which she owned of exactly the same class and kind, there being no other or different stock outstanding, were income to the extent of their value.

The determination is reversed.

Decision will be entered for the petitioner.

Enter:

Entered March 3, 1942.

12 Before United States Board of Tax Appeals,
Washington

Docket No. 110035

SYLVIE R. GRIFFITHS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

In accordance with the Board's Memorandum Opinion entered March 3, 1942, it is

Ordered and Decided that there is no deficiency in income tax for 1939.

Enter:

Entered March 3, 1942.

(S) J. M. STERNHAGEN, *Member.*

13 In United States Circuit Court of Appeals for the
Second Circuit

B. T. A. No. 110035

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
PETITIONER ON REVIEW

v.

SYLVIE R. GRIFFITHS, RESPONDENT ON REVIEW

Petition for review and assignments of error

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now comes the Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General;

J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue; and M. B. Leming, Assistant Chief Counsel, Bureau of Internal Revenue, and respectfully shows:

I

Jurisdiction

The petitioner on review is the duly appointed, qualified, and acting Commissioner of Internal Revenue (hereinafter referred to as the Commissioner), holding his office by virtue of the laws of the United States.

The respondent on review, Sylvie R. Griffiths, (hereinafter referred to as the taxpayer), is an individual whose address for Federal income tax purposes is care of Carter, Ledyard & Milburn, 2 Wall Street, New York, New York. Taxpayer filed her Federal individual income tax return for the calendar year 1939 with the Collector of Internal Revenue for the Second District of New York, whose office is located at New York, New York, and within the judicial circuit of the United States Circuit Court of Appeals for the Second Circuit.

The Commissioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II

Prior Proceedings

On December 8, 1941, the Commissioner determined a deficiency in income tax for the year 1939 in the amount of $9.60,
14 and sent to the taxpayer by registered mail a notice of said deficiency in accordance with the provisions of existing internal revenue laws. Thereafter, and on February 26, 1942, the taxpayer filed a petition for a redetermination of said deficiency by the United States Board of Tax Appeals.

The case was submitted to the Board of Tax Appeals upon the pleadings on March 3, 1942.

On March 3, 1942, the Board entered its memorandum opinion, and also its decision that there is no deficiency in income tax for 1939.

III

Nature of Controversy

The question involved is whether the taxpayer realized taxable income to the extent of the value of certain common stock she

received as dividends in the taxable year upon shares of common stock which she owned.

Taxpayer owned 101 shares of the capital stock of Standard Oil Company (New Jersey). As the result of resolutions adopted by the Board of Directors of that corporation on May 1, 1939, and November 1, 1939, there were distributed to taxpayer as a dividend, on June 15 and December 15, 1939, 2.54 additional shares of the same class of stock, having an aggregate fair market value of $109.01. There was only one class of stock outstanding at the time the distributions were made. There were sufficient earnings and profits accumulated by the corporation subsequent to February 28, 1913, out of which said distributions could be made.

The Commissioner held that the additional shares received as dividends by the taxpayer constituted taxable income to the extent of their fair market value in the sum of $120.16 (should be $109.01).

The respondent on review contended before the United States Board of Tax Appeals that no amount is includible in her gross income by reason of her receipt of said stock dividends.

The Board reversed the Commissioner's determination and redetermined and decided, by its decision entered March 3, 1942, that there is no deficiency in income tax for 1939.

IV

Assignments of Error

The Commissioner avers that in the record and proceeding before the Board of Tax Appeals and in the opinion and
15 final decision rendered and entered by the Board of Tax Appeals, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceeding, opinion, and final decision so rendered and entered by the Board of Tax Appeals:

The Board of Tax Appeals erred:

1. In holding that the additional shares of common stock which taxpayer received as dividends upon her common stock was not income to the taxpayer.

2. In holding that there is no deficiency in income tax for 1939.

3. In failing to hold that there is a deficiency in income tax for the year 1939 in the amount of $8.72.

4. In failing to hold that the common stock which taxpayer received as dividends upon her common stock was income to the taxpayer.

5. In failing to hold that the distributions of common stock which taxpayer received as dividends were paid out of earnings or profits of the corporation accumulated after February 28, 1913.

6. In failing to hold that the taxpayer realized income in the amount of the fair market value of the shares of common stock which she received as stock dividends upon her shares of common stock.

7. In reversing the determination of the Commissioner.

8. In that its opinion and decision are contrary to law.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Second Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed by said Court.

(Signed) SAMUEL O. CLARK, JR.,
Assistant Attorney General.

(Signed) J. P. WENCHEL,
R. L. W.
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
M. B. LEMING,
Assistant Chief Counsel,
Bureau of Internal Revenue.
JMM: mgc-5-14-42.

16 [*Duly sworn to by M. B. Leming; jurat omitted in printing.*]

17 In United States Circuit Court of Appeals
for the Second Circuit

[Title omitted.]

Notice of filing petition for review

To: SYLVIE R. GRIFFITHS,
c/o Carter, Ledyard & Milburn,
2 Wall Street, New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did on the 14th day of May 1942, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C.,

a petition for review by the United States Circuit Court of Appeals for the Second Circuit, of the decision of the Board heretofore rendered in the above-entitled cause. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 14th day of May 1942.

(Signed) J. P. WENCHEL,
R. L. W.
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 19 day of May 1942.

(Signed) SYLVIE R. GRIFFITHS,
Respondent on Review.

18 In United States Circuit Court of Appeals
for the Second Circuit

[Title omitted.]

Praecipe for record

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Second Circuit, copies duly certified as correct of the following documents and records in connection with the petition for review by the said Circuit Court of Appeals for the Second Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
   (a) Petition.
   (b) Answer.
3. Memorandum opinion and decision of the Board.
4. Petition for review.
5. Notices of filing petition for review.
6. This praecipe.

(Signed) J. P. WENCHEL,
R. L. W.
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted and the praecipe is agreed to this 16 day of May, 1942.

(Sgd.) WILL R. GREGG,
ALLEN H. PIERCE,
Counsel for Respondent on Review.

19 [Clerk's certificate to foregoing transcript omitted in printing.]

20 In United States Circuit of Appeals
For the Second Circuit

No. 345—October Term, 1941

(Argued June 11, 1942. Decided June 11, 1942)

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SYLVIE R. GRIFFITHS, RESPONDENT

Appeal from the United States Board of Tax Appeals

Before SWAN, CHASE AND FRANK, *Circuit Judges*

GERALD L. WALLACE, for the Petitioner.
ALLIN H. PIERCE, for the Respondent.

Opinion

Order affirmed in open court on authority of *Eisner* v. *Macomber*, 252 U. S., 189.

21 In United States Circuit Court of Appeals,
Second Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SYLVIE R. GRIFFITHS, RESPONDENT

Judgment filed July 20, 1942

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said United States Board of Tax Appeals be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said Board in accordance with this decree.

D. E. ROBERTS, *Clerk.*

23 [Clerk's certificate to foregoing transcript omitted in printing.]

24 Supreme Court of the United States

No. 467, October Term, 1942

Order allowing certiorari

Filed November 23, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. The case is transferred to the summary docket and assigned for argument on Monday, December 7th next.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompany the petition shall be treated as though filed in response to such writ.

25 [Endorsement on cover:] File No. 46968. U. S. Circuit Court of Appeals, Second Circuit. Term No. 467. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. Sylvie R. Griffiths. Petition for a writ of certiorari and exhibit thereto. Filed October 20, 1942. Term No. 467 O. T. 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1943

FILE COPY

Office - Supreme Court, U. S.
FILED
OCT 20 1942
CHARLES ELMORE CROPLEY
CLERK

No. 467

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SYLVIE R. GRIFFITHS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SYLVIE R. GRIFFITHS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above case on July 20, 1942, affirming the decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 11) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 20), is reported at 129 F. (2d) 321.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 20). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in common stock upon common stock supported by corporate earnings and profits, where there is no other class of stock outstanding, is constitutionally subject to tax without apportionment.

CONSTITUTIONAL PROVISIONS, STATUTE, AND REGULATIONS INVOLVED

The provisions of the Constitution, the statute and the regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The taxpayer was the owner and holder of 10½ shares of capital stock of Standard Oil Company (New Jersey). (R. 6.) Standard had a total authorized capitalization of 30,000,000 shares of stock of a par value of $25 each. On January 1, 1939, there were outstanding approximately 26,500,000 shares, which had an aggregate par value of $662,500,000 (R. 4).

In addition, on January 1, 1939, the corporation had a capital surplus on its books of approximately $66,500,000 and earned surplus and undivided prof-

its of approximately $130,000,000. The amounts represented by the outstanding capital stock, capital surplus, earned surplus and undivided profits were invested in assets or otherwise used by the corporation for purposes of its business (R. 4).

All of the shares of the capital stock of the corporation which were outstanding during the year 1939 were of the same class and character. The rights and interests of the holder of each share were identical with those of the holder of every other share (R. 4).

On May 1, 1939, the board of directors of Standard adopted resolutions directing that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two shares of stock for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913 (R. 4–5).

On November 1, 1939, Standard's board of directors adopted further resolutions directing that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of capital stock of the corporation on the basis of three shares for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of the capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions, and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913 (R. 5).

The shares of stock thus distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former interest. In neither in-

stance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of additional shares of capital stock issued and distributed (R. 5–6).

The taxpayer, on June 15, 1939, received as her proportion of the stock dividend distributed on that date 1.01 shares of the capital stock of the corporation. The fair market value of each share of stock of the corporation on June 15, 1939, immediately after receipt of the additional shares by the taxpayer, was $42.50. The fair market value of the 1.01 additional shares was $42.93 (R. 6).

On December 15, 1939, the taxpayer received in respect of the 102.01 shares of stock of the corporation which she now held, 1.53 additional shares of the stock of the corporation as her proportion of stock dividend distributed on th date. The fair market value of each share of the stock of the corporation on December 15, 1939, immediately after the receipt of the additional shares by the taxpayer, was $43.1875. The fair market value of the 1.53 additional shares was $66.08 (R. 6).

The Commissioner assessed the deficiency based on the failure of the taxpayer to include in her income the fair market value of the two and one-half shares of common stock of Standard received by her as a dividend (R. 8–9). This determination was reversed by the Board of Tax Appeals (R. 12). The Circuit Court of Appeals affirmed on the authority of *Eisner* v. *Macomber*, 252 U. S. 189.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividends could not constitutionally be subjected to tax.

2. In failing to hold that the additional common stock which the taxpayer received as dividends upon her common stock was taxable to her.

3. In affirming the decision of the Board of Tax Appeals.

REASON FOR GRANTING THE WRIT

This is a test case designed to challenge directly the authority of *Eisner* v. *Macomber*, 252 U. S. 189. The public importance of a re-examination of that decision has been set forth in the Government's petitions for certiorari and rehearing thereon in *Helvering* v. *Sprouse*, October Term, 1942, No. 22. The Government proposes to urge that *Eisner* v. *Macomber* be overruled both in the *Sprouse* case and in *Strassburger* v. *Helvering*, October Term, 1942, No. 66. Because of the importance of the question and because the issue is now before the Court in the *Sprouse* and *Strassburger* cases, review of the instant cause is also appropriate.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

OCTOBER 1942.

APPENDIX

Constitution of the United States:

Article I, Section 2, Clause 3.—Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons * * *.

Article I, Section 8, Clause 1.—The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * *

Article I, Section 9, Clauses 4 and 5.—No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

No Tax or Duty shall be laid on Articles exported from any State.

* * * * * *

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *

* * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this title * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * * * *

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights

to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

* * * * *

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Treasury Regulations 101, promulgated under the Revenue Act of 1938.

ART. 115–7 [as amended by T. D. 5110, 1942–4 Int. Rev. Bull. 7]. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.

The provisions of Article 115–7 deleted by T. D. 5110, 1942–4 Int. Rev. Bull. 7, were as follows:

The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the

meaning of the Constitution.[1] The distinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

* * * * *

[The three remaining paragraphs contain examples illustrating the foregoing rules.]

---

[1] See *Eisner* v. *Macomber* (252 U. S. 189, T. D. 3010, C. B. 3, 25 (1920)); and *Koshland* v. *Helvering* (298 U. S. 441, Ct. D. 1124, C. B. XV–1, 219 (1936)). Compare *United States* v. *Phellis* (257 U. S. 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S. 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S. 134, T. D. 3508, C. B. II–2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S. 242, T. D. 3609, C. B. III–2, 51 (1924)); and *Marr* v. *United States* (268 U. S. 536, T. D. 3755, C. B. IV–2, 116 (1925)).

U. S. GOVERNMENT PRINTING OFFICE: 1942

BRIEF FOR THE PETITIONER

FILE COPY

No. 467

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SYLVIE R. GRIFFITHS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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No. 467

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SYLVIE R. GRIFFITHS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 8) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 14) is reported at 129 F. (2d) 321.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 14). The petition for a writ of certiorari was filed on October 20, 1942, and was granted on November 23, 1942. The jurisdiction of this Court rests upon Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in common stock upon common stock supported by corporate earnings and profits, where there is no other class of stock outstanding, is constitutionally subject to tax as income without apportionment, under Sections 22 and 115 of the Internal Revenue Code.

CONSTITUTIONAL PROVISIONS, STATUTE, AND REGULATIONS INVOLVED

The provisions of the Constitution, the statute, and the regulations involved are set forth in Appendix A, *infra*, pp. 34–43.

STATEMENT

This case involves the taxability of two stock dividends declared and paid during the year 1939.

The taxpayer was the owner and holder of 101 shares of capital stock of Standard Oil Company (New Jersey) (R. 4). Standard had a total authorized capitalization of 30,000,000 shares of stock of a par value of $25 each. On January 1, 1939, there were outstanding approximately 26,500,000 shares, which had an aggregate par value of $662,500,000. (R. 3.)

In addition, on January 1, 1939, the corporation had a capital surplus on its books of approximately $66,500,000 and earned surplus and undivided profits of approximately $130,000,000. The amounts represented by the outstanding capital

stock, capital surplus, earned surplus and undivided profits were invested in assets or otherwise used by the corporation for purposes of its business. (R. 3.)

All of the shares of the capital stock of the corporation which were outstanding during the year 1939 were of the same class and character. The rights and interests of the holder of each share were identical with those of the holder of every other share. (R. 3.)

On May 1, 1939, the board of directors of Standard adopted resolutions directing that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two shares of stock for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913. (R. 3.)

On November 1, 1939, Standard's board of directors adopted further resolutions directing that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of capital stock of the corporation on the basis of three shares for each 200 shares held on the record date. The earned surplus account would be charged with $27.50 for each additional share of the capital stock issued. The capital stock account would be credited with the par value of such share, namely, $25, and the capital surplus account would be credited with $2.50. The transfers were made in accordance with these directions, and the new shares were divided among the stockholders in the proportions described. The total amount transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913. (R. 3–4.)

The shares of stock thus distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former inter-

est. In neither instance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of additional shares of capital stock issued and distributed. (R. 4.)

The taxpayer, on June 15, 1939, received as her proportion of the stock dividend distributed on that date 1.01 shares of the capital stock of the corporation. The fair market value of each share of stock of the corporation on June 15, 1939, immediately after receipt of the additional shares by the taxpayer, was $42.50. The fair market value of the 1.01 additional shares was $42.93. (R. 4.)

On December 15, 1939, the taxpayer received in respect of the 102.01 shares of stock of the corporation which she now held, 1.53 additional shares of the stock of the corporation as her proportion of stock dividend distributed on that date. The fair market value of each share of the stock of the corporation on December 15, 1939, immediately after the receipt of the additional shares by the taxpayer, was $43.1875. The fair market value of the 1.53 additional shares was $66.08. (R. 5.)

The Commissioner proposed to assess a deficiency for 1939 based on the failure of the taxpayer to include in her income the fair market value of the shares of common stock of Standard received by her as dividends (R. 6–7). His deter-

mination was reversed by the Board of Tax Appeals (R. 9). The Circuit Court of Appeals affirmed on the authority of *Eisner* v. *Macomber*, 252 U. S. 189. (R. 14.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the stock dividends could not constitutionally be subjected to tax.

2. In failing to hold that the additional common stock which the taxpayer received as dividends upon her common stock was constitutionally taxable to her under Sections 22 and 115 of the Internal Revenue Code.

3. In affirming the decision of the Board of Tax Appeals.

ARGUMENT

Introductory.—This case involves stock dividends of pure common upon common, supported by corporate earnings, where there was no other class of stock outstanding. The taxability of these dividends, therefore, will squarely require the overruling of *Eisner* v. *Macomber*, 252 U. S. 189. The *per curiam* opinion of the court below was based solely upon that decision (R. 14).

In *Strassburger* v. *Helvering* and *Helvering* v. *Sprouse*, Nos. 66 and 22, this Term, we undertook to show at length why *Eisner* v. *Macomber* was incorrectly decided, and we respectfully refer the Court to our brief in the *Strassburger* case for a

full exposition of our argument on this issue.[1] However, the further issue has been raised here, as it was in those cases, that the statutory provisions should be narrowly interpreted so as not to reach these dividends. Accordingly, we shall first discuss somewhat more fully the scope of the statutory provisions; we shall secondly, deal with the related question involving the Treasury regulations; and thirdly, we shall consider in greater detail the public interest which requires the re-examination of *Eisner* v. *Macomber*.

It may be observed at the outset that in none of the cases, whether decided for or against the Government, was there any suggestion that the statute failed to tax the stock dividend if it could be regarded as income within the meaning of the Sixteenth Amendment. The Ninth Circuit in the *Sprouse* case rested its decision squarely upon *Eisner* v. *Macomber*, and indeed stated that "It is conceded that under the taxing act the value of the non-voting common stock, distributed to peti-

[1] In addition, we have set forth herein in Appendix B, *infra*, pp. 44–47, a brief discussion of the cases decided in the other English-speaking countries. The statement was made, erroneously we think, in one of the amicus briefs in the *Strassburger* case that "The doctrine that a stock dividend is not income has been adopted throughout the English speaking world." See brief of John E. Hughes, p. 10.

Although not bearing directly upon the meaning of the sixteenth amendment to our Constitution, those cases in general support the view that the word "incomes" in the Sixteenth Amendment is broad enough to include stock dividends.

tioner as a dividend, was taxable if it was 'income' of the kind which the Sixteenth Amendment authorizes Congress to tax." (See record in *Sprouse* case, p. 52, 122 F. (2d) 973, 975.) Similarly, in the *Strassburger* case, Judge Swan, speaking for himself and Judge A. N. Hand, stated that "It is implicit in this provision [Section 115 (f) of the 1936 Act] that Congress intended to tax stock dividends to the full extent of its constitutional power; and so the Regulations expressly declared." (See record in *Strassburger* case, p. 33, 124 F. (2d) 315, 316.) And Judge Chase, who disagreed as to the ultimate result, dissented on the ground that *Eisner* v. *Macomber* forbade the tax rather than upon a ground of statutory construction.[2] Finally, the court below in the instant case rested its decision solely upon *Eisner* v. *Macomber* (R. 14).

I

THE STATUTORY PROVISIONS

1. The stock dividends herein were payable to the stockholders of record at the close of business on May 16 and November 15, 1939, and were dis-

[2] Similarly, in *Dreyfuss* v. *Manning*, 44 F. Supp. 383 (N. J.), a case substantially identical with the *Strassburger* case, the court followed Judge Chase's dissenting opinion and relied solely upon *Eisner* v. *Macomber*. There was not even the remotest suggestion that the statute was too narrowly drawn to reach the dividend if it were income within the meaning of the Constitution.

tributed on June 15 and December 15, 1939, respectively. The operative statutory provisions, therefore, are found in the Internal Revenue Code (53 Stat. 1), for the income tax chapter of the Code was specifically designated (Section 1) to govern the taxable years beginning after December 31, 1938. Section 115 (f) (1) of the Code, however, is identical with Section 115 (f) (1) of the Revenue Act of 1936, involved in the *Strassburger* and *Sprouse* cases. Moreover, since the provisions of Section 115 (f) first appeared in the 1936 Act, their meaning can best be determined by examining them in the setting of the legislative history of that Act.

The revenue bill which became the 1936 Act (H. R. 12395, 74th Cong., 2d Sess.) was introduced and reported to the House of Representatives on April 21, 1936. Prior to that time the scope of *Eisner* v. *Macomber* had been progressively limited in a series of decisions. See *United States* v. *Phellis*, 257 U. S. 156 (Justices McReynolds and Van Devanter dissenting upon the basis of *Eisner* v. *Macomber*); *Rockefeller* v. *United States*, 257 U. S. 176 (same); *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536 (Justices Van Devanter, McReynolds, Sutherland, and Butler dissenting).[3] And the Court's departure

[3] An apparently temporary trend in the other direction appeared in *Weiss* v. *Stearn*, 265 U. S. 242 (Justices Holmes and Brandeis dissenting), but that trend was soon to be reversed in the *Marr* case, *supra*.

from the theory of *Eisner* v. *Macomber* had been evidenced in a variety of other cases. See (1932) 45 Harv. L. Rev. 1072–1077. See also our brief in the *Strassburger* case, pp. 34–39.

Prior to the 1936 Act, there had been a statutory provision relieving all stock dividends of tax—an exemption which Congress thought had been "required by the decision of the Supreme Court in *Eisner* v. *Macomber*" (H. Rep. No. 350, 67th Cong., 1st Sess., p. 8; S. Rep. No. 275, 67th Cong., 1st Sess., p. 9). The progressive limitation of *Eisner* v. *Macomber*, however, made it clear that so broad an exemption was not necessary. The exemption was accordingly completely eliminated in the 1936 Act. But it was apparent that the process of limitation had not yet ceased, and neither the Treasury nor Congress could know where it would stop. Indeed, *Koshland* v. *Helvering*, 298 U. S. 441, which made further drastic inroads upon the *Macomber* decision, had not yet been decided when the 1936 bill was either introduced or passed by the House.[4] And *Helvering* v. *Gowran*, 302 U. S. 238, which extended the *Koshland* case still further[5] was not to be decided

[4] The *Koshland* case was decided on May 18, 1936. The 1936 bill had already been passed by the House on April 29, 1936. 80 Cong. Rec., part 6, p. 6367.

[5] The *Koshland* case involved a dividend of common stock which was paid to the holders of the preferred and which thereby gave the recipients voting rights not theretofore possessed by them, whereas the *Gowran* case involved a dividend of preferred nonvoting stock which was paid to the common.

until nearly a year and one half after the 1936 Act became law.

Accordingly, Section 115 (f) of the 1936 bill, as introduced and reported to the House, was wisely drafted to be sufficiently flexible to meet all further limitations upon *Eisner* v. *Macomber*. It was framed in the broadest possible terms, and referred to the Sixteenth Amendment itself as marking the limit of its reach. It provided (H. R. 12395, 74th Cong., 2d Sess.):

> (f) STOCK DIVIDENDS.—
>
> (1) GENERAL RULE.—A distribution made by a corporation to its shareholders in stock of the corporation or in rights to acquire stock of the corporation shall be treated as a taxable dividend to the extent that such distribution constitutes income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution and represents a distribution of earnings or profits accumulated after February 28, 1913.

The report of the House Ways and Means Committee left its meaning no less clear. Concisely and unambiguously, the Committee explained these provisions as follows (H. Rep. No. 2475, 74th Cong., 2d Sess., p. 10):

> It is provided in section 115 (f) that stock dividends shall be subject to tax to the extent that such dividends constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution.

This explanation contained no qualification, and did not indicate that the statute was to be read as referring to the Sixteenth Amendment as then interpreted, or as it would be interpreted a few weeks later in the *Koshland* decision, or as it would be interpreted some nineteen months later in the *Gowran* case. It was intended to give this Court a free hand to consider the taxability of any stock dividend as income, unembarrassed by any statutory restriction.

The report of the Senate Finance Committee is equally clear. Although the provisions of Section 115 (f) were restated in the form of a double negative, in an effort to conform to certain changes that were made in Section 115 (a), the critical language was retained ("income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution"), and the Committee plainly stated (S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 18–19):

> This subsection of the House bill, under which stock dividends are made taxable to the full extent permitted by the Constitution, is retained by your committee, except for changes made necessary by virtue of the reported amendment of section 115 (a) and in the interest of greater clarity.

2. The argument that the words "income to the shareholder within the meaning of the Sixteenth Amendment" should not be interpreted to mean

what they say appears to be constructed primarily upon statements made by Mr. Vinson* on the floor of the House. 80 Cong. Rec., part 6, pp. 6214–6215, 6309–6310.

We think that Mr. Vinson's statements, when read in context and in the light of their historical setting, do not require any such disregard of the plain language of the statute or of the clear and carefully prepared explanations of the committees themselves. Mr. Vinson's opening statement explained why the prior exemption of all stock dividends was being eliminated from the statute. He pointed out (p. 6214) that there were "innumerable types" of stock dividends that were constitutionally taxable under *Eisner* v. *Macomber*. However, it must be remembered that most of such dividends were then considered taxable, not because *Eisner* v. *Macomber* recognized them as such, but because of subsequent limitations upon *Eisner* v. *Macomber*. Moreover, the *Koshland* case, which further weakened the *Macomber* decision had not yet been decided by this Court. To be sure, Mr. Vinson declared that the new provisions were not to be regarded (p. 6215) as "an attack upon the Eisner

* It was erroneously stated at the oral arguments of the *Sprouse* and *Strassburger* cases that Mr. Vinson was chairman of the House Ways and Means Committee. Mr. Doughton was the chairman. However, Mr. Vinson was a member of the committee and took an active part in the consideration of the bill.

against Macomber decision." But obviously, all that he meant was that Congress was not *requiring* the taxation of *all* stock dividends in defiance of *Eisner* v. *Macomber;* rather, it was taxing stock dividends to the full extent that they constituted income within the meaning of the Sixteenth Amendment, whatever that extent may be. There was no suggestion that Congress intended to foreclose this Court from reexamining *Eisner* v. *Macomber*. If Congress had so intended, the statute certainly would not have been framed in the specific terms of the Sixteenth Amendment itself. The provisions were designedly drawn in sweeping language with sufficient elasticity to permit the Court to reexamine *Eisner* v. *Macomber,* without at the same time placing Congress in the embarrassing position of making a frontal attack upon the decision. Moreover, the 1936 revenue bill as a whole was the object of vigorous attack by the opposition, and at that time this Court had only recently declared several important Federal statutes unconstitutional; it is therefore easy to see why Mr. Vinson took the pains to explain that he was not sponsoring any unconstitutional legislation. This is confirmed by Mr. Vinson's subsequent colloquy (pp. 6309–6310) with Mr. Treadway, the leader of the opposition, where Mr. Vinson in substance repeated what he had said in his opening statement, and where the

following additional illuminating exchange occurred (p. 6310):[7]

> Mr. TREADWAY. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?
>
> Mr. VINSON of Kentucky. Well, *we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation,* and if they are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes. [Italics supplied.]

We, of course, do not suggest that the Court should not seek every aid in the interpretation

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[7] Similar debates had occurred with respect to the National Labor Relations Act, in which the opponents had argued that the Act would be unconstitutional under recent commerce clause decisions. The sponsors of the Act, however, disavowed any intention to enact unconstitutional legislation; they contended that the Act was designed to go to the limit of the commerce power whatever that limit may be. And this Court has since ruled in *National Labor Relations Board* v. *Fainblatt*, 306 U. S. 601, 607, that the Act represents an exercise of the commerce power to the full extent permissible under the Constitution. Compare *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, 121–126, which is even stronger, for the Court ignored contrary statements made by some members of the Senate.

of the statute here involved (cf. *United States* v. *Amer. Trucking Ass'ns*, 310 U. S. 534, 543–544). But we vigorously urge that where the statute is framed in clear terms, and where the reports of the committees of both Houses are equally clear,* the Court should not refuse to give effect to that language merely because there is a statement in the debates which is at most ambiguous and which is as consistent with the plain meaning of the statute as it is with an opposing view.

* In view of the clear language of the statute and the unambiguous intention of Congress, as expressed in the committee reports, there is no room for the application of the rule that statutes should be construed so as to avoid constitutional issues. Compare the remarks of Mr. Justice Cardozo in *Hopkins Savings Assn.* v. *Cleary*, 296 U. S. 315, 334–335:

> Courts have striven mightily at times to canalize construction along the path of safety. *Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373, 379. When a statute is reasonably susceptible of two interpretations, they have preferred the meaning that preserves to the meaning that destroys. *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366, 407; *Knights Templars' Indemnity Co.* v. *Jarman*, 187 U. S. 197, 205; cf. *Illinois Central R. Co.* v. *Public Utilities Comm'n*, 245 U. S. 493, 510; *Savage* v. *Jones*, 225 U. S. 501, 533. "But avoidance of a difficulty will not be pressed to the point of disingenuous evasion." *Moore Ice Cream Co.* v. *Rose*, *supra*. "Here the intention of the Congress is revealed too distinctly to permit us to ignore it because of mere misgivings as to power." *Ibid.* The problem must be faced and answered.

3. There is no more reason to read *Eisner* v. *Macomber* as a gloss upon the broad language of Section 115 (f) than there was to read *Collector* v. *Day*, 11 Wall. 113, as a limitation upon the general language in Section 22 (a) of the revenue acts which defined gross income as including "income derived from salaries, wages, or compensation for personal service." And there was never any serious dispute that Section 22 (a) was not sufficiently sweeping to encompass any restrictions upon the decision of *Collector* v. *Day* (cf. *Helvering* v. *Gerhardt*, 304 U. S. 405), or indeed, the overruling of *Collector* v. *Day*. Thus, after the *Gerhardt* decision, when the overruling of *Collector* v. *Day* appeared imminent in *Graves* v. *N. Y. ex rel O'Keefe*, 306 U. S. 466, which was then pending, Congress found it necessary to enact legislation (Public Salary Tax Act of 1939, 53 Stat. 574) which would relieve state employees from the hardship involved in the retroactive application of the new decision.*

Moreover, although the Public Salary Tax Act also amended Section 22 (a) prospectively by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State * * *"), it did so only out of an abun-

* The Treasury expects to propose similar legislation here if *Eisner* v. *Macomber* is overruled. See *infra*, p. 55.

dance of caution. Thus, the report of the House Ways and Means Committee plainly stated (H. Rep. No. 26, 76th Cong., 1st Sess., pp. 3–4):

> Section 1: Section 1 of the bill amends section 22 (a) of the Revenue Act of 1938 (which defines gross income) by providing expressly that there shall be included in gross income, salaries, wages, or compensation for "personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing." Under this amendment the wages, salaries, and compensation of all officers and employees of the respective States and of their political subdivisions and agencies and instrumentalities, without exception, are included in gross income. *The committee recognizes that the language of section 22 (a) as it previously existed was broad enough to include in gross income the compensation of such officers and employees.* The Treasury Department, however, believing the compensation of some of these officers and employees to be constitutionally exempt has, until recently, by administrative action treated their compensation as nontaxable. This administrative action, followed by repeated reenactment of the statutory provisions without change, might lead to the contention that Congress by such reenactment had exempted such State and local officers and employees. This contention would only serve to con-

> fuse the issue of the constitutionality of the future taxation of all State and local officers and employees. To eliminate the possibility of such confusion, therefore, your committee recommends amendment of the Revenue Act of 1938 to insert the proposed language so that there can be no doubt whatever of the intention of Congress that all State and local officers and employees, without exception, shall be subject to Federal income tax for taxable years beginning after December 31, 1938. It is not to be inferred from this amendment, however, that those groups of State and local officers and employees from whom Federal income taxes have previously been collected were not subject to tax under the language of section 22 (a) in earlier revenue acts or in the Revenue Act of 1938 as it existed prior to the amendment proposed in the bill. [Italics supplied.]

See also S. Rep. No. 112, 76th Cong., 1st Sess., pp. 10–11.

4. The contention was made in one of the amicus briefs in the *Strassburger* case that legislation which seeks the limits of constitutional power is vague and undesirable and that therefore this Court should give it a narrower interpretation. However, statutory provisions of this type are not at all unfamiliar and the Court has given full effect to such legislation in situations that are far more dramatic and sweeping than the present case.

In *United States* v. *Wrightwood Dairy Co.*, 315 U. S. 110, the Court held that in the agricultural legislation there involved Congress had intended to exercise its power to the full extent permissible under the Constitution. It will be recalled that the agricultural legislation was pending in Congress when *Schechter Corp.* v. *United States*, 295 U. S. 495, was decided; and that there was substituted in place of the broad language of the pending bill language regarded as more restrictive in the light of the *Schechter* opinion, which reflected a more limited view of the commerce clause. Nevertheless, this Court held in the *Wrightwood* case that the statute was intended to go the whole way and was not to be limited by the concepts of commerce set forth in the *Schechter* opinion whence the statutory language was derived.[10]

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[10] To be sharply distinguished from the present case as well as the *Wrightwood* case is *Parker* v. *Motor Boat Sales*, 314 U. S. 244. In a doubtful and probably erroneous decision, *Southern Pacific Co.* v. *Jensen*, 244 U. S. 205, it had been held that a state was without constitutional authority to enact certain workmen's compensation legislation with respect to a stevedore engaged in work of a maritime nature upon navigable waters within the state. The basis of the decision was that the Constitution had committed exclusive jurisdiction over such matters to the national government. Although Congress was not anxious to enter the field, it nevertheless thereafter enacted like legislation for the benefit of the employees and their families, but provided that the Act was to be applicable only if recovery through workmen's compensation proceedings "may not validly be provided by State law." The widow and children of a deceased employee

Similarly, the National Labor Relations Act became law at a time when the commerce clause had received a narrow interpretation. Yet the Court recognized that it was framed in sufficiently broad terms to constitute an exercise of the commerce power to the full extent of the Constitution. *National Labor Relations Board* v. *Fainblatt*, 306 U. S. 601, 607.

Indeed, the present case is stronger, for here the statute makes specific reference to the Constitution itself.

Even more sweeping are the provisions of the so-called civil rights statute which penalizes a conspiracy to injure, oppress, or intimidate any citizen "in the free exercise or enjoyment of any right or privilege secured to him by the Constitution or laws of the United States". U. S. C., Title

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sought compensation under the federal Act in the *Motor Boat Sales* case; it was argued in opposition to their claim that the statute did not apply because the *Jensen* case had been erroneously decided and compensation could "validly be provided by State law." To have accepted that contention, however, would have meant that the very object which Congress sought to attain—namely, the protection of the employees and their families—would have been defeated in that case. The Court accordingly gave effect to the dominant purpose of Congress by construing the word "validly" as meaning within constitutional limits as then recognized by existing decision.

No such considerations are present here. No congressional purpose would be furthered by any such interpretation of this statute, which seeks to expand the taxing power over stock dividends to the full extent permitted by the Sixteenth Amendment.

18, Sec. 51. See *Motes* v. *United States*, 178 U. S. 458, 462. Again, there are a large number of federal crimes which are so defined as to include only acts committed "upon the high seas, or on any other waters within the admiralty and maritime jurisdiction of the United States." See U. S. C., Title 18, Secs. 451, 482, 483, 484, 487, 489, 490, 491, 492, 497. These statutes make applicable two constitutional provisions: Article I, Sec. 8, cl. 10, dealing with crimes on the "high seas," and Article III, Sec. 2, extending federal judicial power to all cases of "admiralty and maritime Jurisdiction."

Finally, as recently as this year, the Court stated in the saboteur cases (*Ex parte Quirin*, opinion dated October 29, 1942, pp. 8–9):

> By the Articles of War, and especially Article 15, Congress has explicitly provided, so far as it may constitutionally do so, that military tribunals shall have jurisdiction to try offenders or offenses against the law of war in appropriate cases. * * *

Thus, that legislation, with its severe penalties, called into play the entire sweep of constitutional power as well as that nebulous field, the "law of war."

II

THE TREASURY REGULATIONS

1. This case involves the taxable year 1939, the returns for which were due on March 15, 1940.

The *only* Treasury regulations applicable to the year 1939 are Regulations 103, which were promulgated on January 29, 1940. The provisions relating to stock dividends are contained in Section 19.115–7, the first sentence of which reads as follows:

> SEC. 19.115–7. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend *to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.* * * * [Italics supplied.]

As originally issued, this sentence was followed by a discussion (taken largely from the opinion in the *Koshland* case) as to what this Court had ruled in the past with respect to the scope of the Sixteenth Amendment; and that discussion was in turn followed by three examples which represented the holdings of this Court in three decisions, namely, (1) the *Koshland* case, (2) *Eisner* v. *Macomber,* and (3) *Helvering* v. *Gowran,* 302 U. S. 238.

On November 15, 1940, less than ten months after Regulations 103 had been promulgated, the Commissioner of Internal Revenue and the Secretary of the Treasury, by T. D. 5020, 1940–2 Cum. Bull. 118, amended Section 19.115–7, striking out all of the matter appearing after the first sentence, quoted above. To the extent that this amendment had any significance, it applied to the year 1939

(the first year governed by Regulations 103) as well as to subsequent years, for Section 3791 (b) of the Code specifically provides:

> SEC. 3791. RULES AND REGULATIONS
>
> * * * * *
>
> (b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe *the extent, if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect. [Italics supplied.]

Thus, these provisions make it clear beyond question that the new regulations are to have universal application, both prospective and retrospective,[11] *unless* the Secretary of the Treasury or the Commissioner has prescribed that they may operate without retroactive effect. But neither the Secretary nor the Commissioner has so prescribed with respect to this amendment, and we do not understand respondent to contend the contrary.

[11] Normally, even if an amendment in any particular regulations were permitted to be fully retroactive, it could affect liability for only a very few tax years. For there is generally a separate set of regulations with respect to each revenue act, and since each revenue act governs liability for at most only several years, the amendment of any Treasury regulations would not reach back of the revenue act under which they were issued. Moreover, the three-year statute of limitations (see Section 275 of the Code) would in any event operate as an outside limit for the reopening of liability with respect to past years.

The history of the foregoing provisions of Section 3791 (b) is illuminating, and is set forth in detail in Appendix C, *infra*, pp. 48–55.

2. Although we think that the regulations should be considered only as amended, we submit that even in their original form they do not foreclose the reexamination of *Eisner* v. *Macomber*.

The original regulations were of a unique character, unlike any which this Court has had occasion to consider. They consisted essentially of three parts. Only the first part, the first sentence, purported to be an interpretation of the statute, and it declared that a stock dividend "shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution." The second part consisted of a discussion, not of the statute, but of constitutional principles, and was prefaced by a sentence reading "The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution." At that point there was a footnote, citing a number of decisions, and the sentence was then followed by a discussion that was taken largely from the *Koshland* opinion. Nowhere in this discussion was there any indication that the Treasury was doing anything more than attempting to restate the constitutional principles expounded in the decided cases; and nowhere did it

indicate that the Treasury *construed* the statute more narrowly than the Constitution itself. The third and final part of these regulations consisted simply of three examples which in substance merely stated the holdings of the *Koshland, Macomber* and *Gowran* cases, respectively, without specifically identifying them.

Accordingly, even if the second and third parts of these regulations, which had been eliminated, are taken into account, they represented simply an effort by the Treasury to set forth the principles of decided cases—principles of constitutional law, and not an interpretation of the statute. This case is therefore much stronger than the analogous situation in *Helvering* v. *Hallock*, 309 U. S. 106, 121, n. 8, where the Court held that the Treasury was not bound by regulations which it had promulgated under the compulsions of certain earlier decisions and which did not in fact represent its interpretation of the statute. The situation here is stronger, because the regulations herein, apart from the first sentence, did not even purport to be an interpretation of Congressional intent. Finally, to the extent that these regulations might otherwise apply to prevent the imposition of the tax they are invalid. Cf. *Helvering* v. *Gerhardt*, 304 U. S. 405, 422–423.

III

THE IMPORTANCE OF OVERRULING EISNER *v.* MACOMBER

In our brief in the *Strassburger* case we undertook to demonstrate at length that *Eisner* v. *Macomber* was erroneously decided; and in Points I and II of this brief we have endeavored to show that the question is squarely presented here, that the statute was carefully framed so as to impose the tax if the dividend constituted income within the meaning of the Sixteenth Amendment, and that the regulations do not stand in the way. We think that there can be no serious question as to whether the issue is squarely raised. Moreover, there are considerations of great public importance which require that *Eisner* v. *Macomber* be reexamined.

The importance of overruling *Eisner* v. *Macomber* is not merely that the Government may be able to tax stock dividends, although many millions of dollars in taxes may be involved each year with respect to stock dividends. Of far greater importance is the removal of the restriction that it imposes upon the taxation of corporate earnings in the hands of the shareholders at the appropriate surtax levels.

In the Civil War income tax law, corporate earnings were taxed directly to the stockholders, whether or not the earnings were in fact distributed to them, just as though they were mem-

bers of a partnership. *Collector* v. *Hubbard*, 12 Wall. 1. And to a limited extent after the adoption of the Sixteenth Amendment, Congress attempted to tax stockholders directly with respect to corporate earnings where the corporation was used for the purpose of avoiding surtax.[12] But it was thought that such provisions could not survive *Eisner* v. *Macomber*, for in ruling that stock dividends based upon corporate earnings could not be taxed the majority opinion stated the essense of its holding as follows (252 U. S. at 211):

> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. * * *

This did not appear to be mere obiter dicta, particularly since the Court further stated (252 U. S. at 217–219) that *Collector* v. *Hubbard* must be regarded as overruled. The very heart of decision seemed to be that there could be no "in-

[12] See Section 220 of the Revenue Act of 1918, 40 Stat. 1057; Section 3 of the Revenue Act of 1916, 39 Stat. 756; Section II, A, subdivision 2, of the Revenue Act of 1913, 38 Stat. 114, 166–181.

come" constitutionally to the stockholders with respect to the earnings of their corporation until those earnings were distributed. Accordingly, as a result of *Eisner* v. *Macomber*, Congress promptly repealed the tax upon the stockholders,[12] and the reason for the change was noted by the committees of both Houses. See H. Rep. No. 350, 67th Cong., 1st Sess., pp. 12–13:

SURTAX EVASION BY CORPORATE ORGANIZATION

Section 226: Section 220 of the existing law provides that if any corporation is formed or availed of for the purpose of evading the surtax upon its stockholders through the medium of permitting its gains and profits to accumulate instead of being divided, the stockholders shall be taxed in the same manner as partners. By reason of the recent decision of the Supreme Court in the stock dividend case (*Eisner* v. *Macomber*, 252 U. S., 189), considerable

[12] In place of these provisions there were substituted less satisfactory provisions which imposed an artificial flat rate penalty tax upon the corporation itself where it had been formed or availed of for the purpose of preventing the imposition of the surtax upon its stockholders. See Section 220 of the Revenue Act of 1921, 42 Stat. 227; Section 220 of the Revenue Act of 1924, 43 Stat. 253; Section 220 of the Revenue Act of 1926, 44 Stat. 9; Section 104 of the Revenue Act of 1928, 45 Stat. 791; Section 104 of the Revenue Act of 1932, 47 Stat. 169; Section 102 of the Revenue Act of 1934, 48 Stat. 680; Section 102 of the Revenue Act of 1936, 49 Stat. 1648; Section 102 of the Revenue Act of 1938, 52 Stat. 447; Section 102 of the Internal Revenue Code, 53 Stat. 1.

doubt exists as to the constitutionality of the existing law. * * *

See also S. Rep. No. 275, 67th Cong., 1st Sess., p. 16.

Of even greater significance, however, than the corporations availed of for the *purpose* of preventing the imposition of surtaxes, was the great mass of business corporations generally which in their normal operations distributed only a portion of their earnings as dividends, with the result that the remaining earnings would escape surtax in the hands of the stockholders. Growing concern over the situation led the President to send a special message to Congress in 1936 (see House Doc. No. 418, 74th Cong., 2d Sess.), in which he declared (pp. 2–3):

> The accumulation of surplus in corporations controlled by taxpayers with large incomes is encouraged by the present freedom of undistributed corporate income from surtaxes. Since stockholders are the beneficial owners of both distributed and undistributed corporate income, the aim, as a matter of fundamental equity, should be to seek equality of tax burden on all corporate income whether distributed or withheld from the beneficial owners. As the law now stands our corporate taxes dip too deeply into the shares of corporate earnings going to stockholders who need the disbursement of dividends, while the shares of stockholders who can afford to leave

earnings undistributed escape current surtaxes altogether.

This method of evading existing surtaxes constitutes a problem as old as the income tax law itself. Repeated attempts by the Congress to prevent this form of evasion has not been successful. The evil has been a growing one. It has now reached disturbing proportions from the standpoint of the inequality it represents and of its serious effect on the Federal revenue. Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand; it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over $1,300,000,000.

In order to meet in part that staggering loss of revenue the President recommended the repeal of existing corporate taxes and the imposition of an undistributed profits tax. The undistributed profits tax could not fully meet the deficiencies of existing law, but it would succeed to the limited extent that it would induce distributions of corporate earnings which would then be taxed at the appropriate surtax levels, leaving the remaining

earnings to be reached by the undistributed profits tax itself.[14]

It is not unreasonable to suppose that it was thought that *Eisner* v. *Macomber* prevented the adoption of a much more complete and less circuitous solution, namely the imposition of a tax directly upon the stockholders with respect to their pro rata share of corporate earnings, whether or not distributed to them.[15] But in any event the hearings and debates upon the 1936 revenue bill show that such fears of unconstitutionality, engendered by *Eisner* v. *Macomber*, foreclosed that alternative as a possible solution.

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[14] The new system proposed by the President apparently would not close the gap completely, for his estimate that the new taxes would produce $620,000,000 additional revenue (p. 3) should be contrasted with his statement that the Government would lose over $1,300,000,000 in one year under the old system.

[15] A direct tax upon stockholders has been successfully employed to a considerable extent in various foreign countries, notably Australia. See Proceedings, National Tax Association, 1939, p. 548. Moreover, the Final Report of the Committee of the National Tax Association on Federal Taxation of Corporations recommended that the partnership method be applied to the taxation of corporate earnings to the limit of its legal and administrative possibilities; and it was stated that "the number of corporations to which the partnership method can be applied without involving formidable administrative difficulties is far greater than is generally realized". *Id.*, pp. 555, 579–580.

But the Committee was careful to note the constitutional doubts which would be raised by such a method of taxing corporate earnings, and indeed recommended that the Constitution be amended, if that should be necessary. *Id.*, pp. 548, 579.

Thus, in the Senate debates upon the undistributed profits tax, the following occurred (80 Cong. Rec., part 8, p. 8813):[18]

> Mr. ADAMS. Mr. President, is it possible from a legal and administrative standpoint to assimilate the tax procedure applicable to corporations as is done in the case of a partnership?
>
> Is it legally possible to say to each corporation, "Make a report of the proportionate earnings of each stockholders", as we would to a partnership, and then let the stockholder make his return?
>
> Mr. BLACK. Unfortunately that was done about 60 years ago, and while it is my recollection that the Supreme Court itself sustained the act [presumably referring to *Collector* v. *Hubbard*, 12 Wall. 1], it later, by another divided opinion [presumably referring to *Eisner* v. *Macomber*], changed its mind and struck down the act as being in contravention of the Constitution. So that it is impossible to tax the undistributed profits which remain in the corporate treasury as a part of the individual incomes of the stockholders.

Similarly, in the Hearings of the House Ways and Means Committee on the 1936 revenue bill, Rep-

[18] In the Hearings on the 1936 revenue bill the Senate Finance Committee was told by a tax expert that "our constitution says that we cannot tax individuals upon the undistributed profits of their corporations." P. 255. Cf. p. 696. See also Proceedings, National Tax Association, 1939, pp. 548, 555.

resentative David J. Lewis of Maryland stated (p. 193):

> Mr. LEWIS. I do not know that it is fully understood by the public that this roundabout device of compelling the distribution of the real income of the corporation to its shareholders, so that the shareholders may be called upon to pay taxes upon their income, is due to a decision of a divided court. Some years ago the Supreme Court in a sharp decision determined that we could not do in the United States with regard to earned dividends that were not distributed what they do in other countries, especially in England, require the shareholder to pay his tax on his income just the same whether his company had refused to distribute it or not.
>
> Now, if that decision [17] of the Court should be reversed, what we are doing here, or attempting to do in order to reach the taxpayer here, the method of our attempt, would not be necessary. Not ours the fault of all this clumsiness and indirection of approach to a necessary public object.

See also pp. 96, 98, 321, 322, 340, 341, 745.

Whether it was rightly or wrongly thought that *Eisner* v. *Macomber* prevented such a system of taxation, the fact is that the very existence of

[17] In a letter subsequently written to the editors of the University of Pennsylvania Law Review, Representative Lewis confirmed the fact that he was referring to *Eisner* v. *Macomber*. See 85 U. of Pa. L. Rev. 83, 86, n. 17.

Eisner v. *Macomber* rules out such a tax as a practical matter, for it is obvious that, unlike other types of legislation, no system of taxation may be deliberately adopted as a major part of our fiscal scheme so long as there exists doubt as to its ultimate fate in the courts.

Moreover, even if Congress should again prefer to tackle the problem in whole or in part through the undistributed-profits tax, *Eisner* v. *Macomber* stands in the way of a suitable statute. The 1936 undistributed-profits tax, as enacted, was the source of widespread dissatisfaction and irritation. There were countless complaints that corporations were being forced into making distributions of assets that were unsound from a business point of view, in order to avoid the rigors of the undistributed-profits tax. However, if *Eisner* v. *Macomber* did not block the way, stock dividends could be declared against the earnings in such manner that there would be no disturbance of the corporate structure.[18] Accordingly, a far more workable and satisfactory undistributed-profits tax could be achieved if *Eisner* v. *Macomber* were

[18] Of course, stock dividends of the *Koshland* type would not involve any distribution of corporate assets, but the scope of the *Koshland* case itself was too uncertain (for example, its applicability is now being vigorously contested in the *Sprouse* and *Strassburger* cases); and in any event such dividends might involve an unsound dislocation of the corporate framework. See Proceedings, National Tax Association, 1939, pp. 549, 550, 555–558.

overruled. And particularly at this time, when the maximum revenues are needed by the Government and when it becomes of even greater importance that additional taxes be imposed as equitably as possible, neither the Treasury nor Congress should be straight-jacketed in the formulation of new legislation by an erroneous constitutional decision of sweeping dimensions.

CONCLUSION

The judgment below should be reversed.

Respectfully submitted.

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DECEMBER 1942.

APPENDIX A

Constitution of the United States:

Article I, Section 2, Clause 3.—Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons * * *.

Article I, Section 8, Clause 1.—The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

* * * * *

Article I, Section 9, Clauses 4 and 5.—No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

No Tax or Duty shall be laid on Articles exported from any State.

* * * * *

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code (53 Stat. 1):

SEC. 1. APPLICATION OF CHAPTER.

The provisions of this chapter shall apply only to taxable years beginning after December 31, 1938. Income, war-profits, and excess-profits taxes for taxable years beginning prior to January 1, 1939, shall not be affected by the provisions of this chapter, but shall remain subject to the applicable provisions of the Revenue Act of 1938 and prior revenue acts, except as such provisions are modified by legislation enacted subsequent to the Revenue Act of 1938.

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.

* * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) DEFINITION OF DIVIDEND.—The term "dividend" when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) SOURCE OF DISTRIBUTIONS.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113.

* * * * *

(f) STOCK DIVIDENDS.—

(1) GENERAL RULE.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) ELECTION OF SHAREHOLDERS AS TO MEDIUM OF PAYMENT.—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend

in the hands of all shareholders, regardless of the medium in which paid.

* * * * * *

(j) VALUATION OF DIVIDEND.—If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

* * * * * *

Treasury Regulations 103, promulgated January 29, 1940, under the Internal Revenue Code:

SEC. 19.115–7 [as amended by T. D. 5020, 1940–2 Cum. Bull. 118, issued November 15, 1940]. *Stock dividends.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution.

The amendment made by T. D. 5020 consisted simply of the *addition* of the following material which had previously followed the sentence quoted above:

The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution.[1] The dis-

[1] See *Eisner* v. *Macomber* (252 U. S., 189, T. D. 3010, C. B. 3, 25 (1920)); *Koshland* v. *Helvering* (298 U. S., 441, Ct. D. 1124, C. B. XV–1219 (1936)); *Helvering* v. *Gowran* (302 U. S. 238, C. B. 1938–1, 340); and *Helvering* v. *Pfeiffer* (302 U. S., 247,

tinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

Example (1): The X Corporation had an authorized capital stock of $300,000 of common stock, par value $10 a share, and $100,000 of 7 percent cumulative preferred stock, par value $100 a share, which is preferred as to dividends, has no voting rights, and may be redeemed at any time at $105

C. B. 1938-1, 304). Compare *United States* v. *Phellis* (257 U. S., 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S., 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S., 134, T. D. 3508, C. B. II-2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S., 242, T. D. 3609, C. B. III-2, 51 (1924)); and *Marr* v. *United States* (268 U. S., 536, T. D. 3755, C. B. IV-2, 116 (1925)).

per share. The articles of incorporation provide that the annual dividend on the preferred stock may be paid in cash or, at the option of the corporation, in one share of common stock for each share of preferred. On July 1, 1939, the X Corporation had outstanding $200,000 of common stock and $100,000 of preferred stock, earnings and profits of $60,000 accumulated since February 28, 1913, and earnings and profits of the taxable year amounting to $15,000. On July 1, 1939, it distributed 1,000 shares of its common stock of an aggregate par value (and fair market value) of $10,000 to the holders of its preferred stock in payment of the annual dividend on such stock. The stock so distributed constitutes a taxable stock dividend to the holders of the preferred stock.

Example (2): On July 1, 1939, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1939, the Y Corporation issued and divided among its shareholders 250 additional shares of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

Example (3): The Z Corporation had an authorized capital stock of 30,000 shares of common, without par value, and 10,000 shares of 7 percent cumulative preferred stock, par $100, which is p[illegible]rred as to

dividends, has voting rights, and may be redeemed on the 1st of January or July of any year by the payment of $105 per share and accrued dividends. On July 1, 1939, the company's issued and outstanding stock amounted to 20,000 shares of common and 6,000 shares of preferred, and it had $250,000 earnings and profits accumulated since February 28, 1913, and $90,000 earnings and profits of the taxable year. On July 1, 1939, it paid a dividend on its common stock in preferred stock at the rate of 1/10 share of preferred on each share of common outstanding. The preferred stock so distributed constitutes a taxable stock dividend to the holders of common stock.

APPENDIX B

THE TAXABILITY OF STOCK DIVIDENDS IN OTHER ENGLISH-SPEAKING COUNTRIES

The decisions in other English-speaking jurisdictions are not directly illuminating upon the construction to be accorded the Sixteenth Amendment to our Constitution. However, the light which they do throw upon the question supports our contention that the word "incomes" in the Sixteenth Amendment is broad enough to include stock dividends.

Canada.—In Canada the statute expressly includes stock dividends within the tax upon the receipt of dividends, and these provisions have been applied to common-on-common stock dividends by the Exchequer Court of Canada. *The King* v. *Johnson Matthey & Co.*, [1938] Ex. C. R. 141.

South Africa.—In South Africa the statute includes as income subject to super tax "an amount equal to the nominal value of any bonus shares, debentures or other securities awarded to the taxpayer by way of capitalizing the profits of a company * * *" This provision was applied to include stock dividends in *Liddell* v. *Commissioner for Inland Revenue* (1939), So. Afr. L. R. (Cape of Good Hope Provincial Division) 161.

Australia.—Stock dividends are also treated as income in Australia. *Swan Brewery Co.* v. *The*

King, [1914] A. C. 231, involved a statute of Western Australia which levied a tax upon every company declaring a dividend, the term "dividend" being defined as including "every profit, advantage, or gain intended to be paid or credited to or distributed among" the members of the company. The Supreme Court of Western Australia held that a common-on-common stock dividend was subject to the tax and its judgment was affirmed by the Privy Council.

James v. *Federal Commissioner of Taxation*, 34 Commw. L. R. 404 (High Court of Australia 1924) involved a statute which provided that "The income of any person shall include * * * dividends, interest, profits, or bonus credited or paid to any depositor, member, or shareholder." The taxpayer was a shareholder of a corporation which distributed partly paid-up common shares as a dividend upon its outstanding stock, which consisted solely of common shares. It was held that the partly paid-up shares constituted income *pro tanto* within the meaning of the statute.

A similar result was reached in *Nicholas* v. *Commissioner of Taxes of the State of Victoria*, [1940] A. C. 744, in which the Privy Council sustained a judgment of the High Court of Australia (59 Commw. L. R. 230) that a common-on-common stock dividend was taxable as income under a statute of Victoria similar to that considered in the *James* case.

The Australian Income Tax Assessment Act, 1936–1940, No. 17 of 1940, now defines a dividend to include (sec. 6) "the paid-up value of shares distributed by a company to its shareholders to

the extent to which the paid-up value represents a capitalization of profits."

England and India.—The question was considered under the English Act in *Commissioners of Inland Revenue* v. *Blott*, [1921] 2 A. C. 171, in which a bare majority of the House of Lords held a stock dividend to be not taxable. The decision has been regarded as turning, however, upon the point that a stock dividend was not a *payment* by the corporation within the meaning of the statutory phrase, "rents, interests, annuities or other annual payments * * * "[1] See the opinions of Isaacs, J., in *James* v. *Federal Commissioner of Taxation, supra*, pp. 413–416, and of Lord Thankerton in *Nicholas* v. *Commissioner of Taxes of the State of Victoria, supra*, pp. 755–758. Thus, even dividends of preferred stock (see the *Blott* case, *supra*) and of debentures (*Commissioners of Inland Revenue* v. *Fisher's Executors*, [1926] A. C. 395 (House of Lords)) do not fall within the meaning of that statutory provision. The same results have been reached under the Indian Act which is similar to the English Act upon this point. *Commissioner of Income-Tax, Bengal* v. *Mercantile Bank of India, Ltd.*, [1936] A. C. 478 (House of Lords).

The significant consideration with respect to all of the foregoing cases is that stock dividends were treated as taxable income where the statute was properly framed. For, as the *James* and *Nicholas* cases plainly indicate, the *Blott* case and

[1] The statutory provisions are set out in the opinions in the Court of Appeal, [1920] 2 K. B. 657, 668, and of Rowlatt, J., [1920] 1 K. B. 114, 115, 132.

its progeny do not stand in the way of including stock dividends within taxable income if the statute is properly drawn. And equally significant for present purposes is the fact that the legislatures of most of the English-speaking jurisdictions have treated stock dividends as income. Thus, when it is sought to tax "income," stock dividends are thought of as naturally falling into that category along with other kinds of income. We submit that this shows that the ordinary meaning of the word "income" is broad enough to include stock dividends. And, as we pointed out in our brief in the *Strassburger* case (p. 22–23), the Sixteenth Amendment, like every other constitutional provision, should be broadly interpreted so as to give Congress whatever power can reasonably be read into its terms. To deny to Congress, as did *Eisner* v. *Macomber*, the power to treat stock dividends as income—a power found necessary of exercise by the majority of the other English-speaking jurisdictions in the development of a sound system of progressive income taxation—is to construe the Sixteenth Amendment in direct violation of its purpose.

APPENDIX C

RETROACTIVE REGULATIONS

The plenary power to prescribe the extent to which any ruling, regulation, or Treasury Decision may operate with[1] or without retroactive effect is plainly recognized by Section 3791 (b) of the Internal Revenue Code (53 Stat. 1) which provides:

> SEC. 3791. RULES AND REGULATIONS.
>
> * * * * * *
>
> (b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

The first comparable statutory provisions were of a more limited character, and appeared in the Revenue Act of 1921, 42 Stat. 227. Section 1314 of that Act provided:

RETROACTIVE REGULATIONS

> SEC. 1314. That in case a regulation or Treasury decision relating to the internal-revenue laws made by the Commissioner or the Secretary, or by the Commissioner with

[1] For decisions involving retroactive application of regulations, see *Morrissey* v. *Commissioner*, 296 U. S. 344, 355; *Murphy Oil Co.* v. *Burnet*, 287 U. S. 299; *Manhattan Co.* v. *Commissioner*, 297 U. S. 129.

> the approval of the Secretary, is reversed by a subsequent regulation or Treasury Decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

In commenting upon those provisions (referred to as Sec. 1002 in the House bill), the House Ways and Means Committee stated (H. Rep. No. 350, 67th Cong., 1st Sess., p. 15):

> Section 1002 would permit the Treasury Department to apply without retroactive effect a new regulation or Treasury decision reversing a prior regulation or Treasury decision, unless such reversal is occasioned or required by a decision of a court of competent jurisdiction.

And the Senate Finance Committee similarly remarked (S. Rep. No. 275, 67th Cong., 1st Sess., p. 32):

> Section 1314 of the proposed bill authorizes the commissioner, with the approval of the Secretary, to provide in making a regulation or Treasury decision which reverses a prior regulation or Treasury decision (if it is not immediately occasioned by a decision of a court of competent jurisdiction) that the new regulation or Treasury decision may be applied without retroactive effect.

Thus, it was clear that under the 1921 Act, any change in the regulations was to operate

retrospectively as well as prospectively, unless the Treasury determined to permit the change to operate prospectively only. But where the change in regulations was occasioned by judicial decision the Treasury was to have no discretion; such change was to affect all tax years, both before and after the change.

The next revenue act, the Revenue Act of 1924, 43 Stat. 253, made no change in these provisions which were embodied in Section 1008 (a) of that Act. Thereafter, the same provisions were carried over as Section 1108 (a) of the Revenue Act of 1926, without any alteration. However, Section 605 of the Revenue Act of 1928, 45 Stat. 791, amended Section 1108 (a) of the 1926 Act as follows:

> SEC. 605. RETROACTIVE REGULATIONS.
>
> Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:
>
> "SEC. 1108. (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect."

The purpose of the amendment was to increase further the discretion given to the Treasury. It was intended to permit the Treasury to determine whether a change in regulations should operate prospectively only, even where the change was induced by judicial decision. This was made abundantly clear by the Senate Finance Committee

which stated (S. Rep. No. 960, 70th Cong., 1st Sess., p. 40):[2]

> Section 1108 (a) of the revenue act of 1926 provides that where a regulation or Treasury decision is reversed by a subsequent regulation or Treasury decision, the subsequent decision may be applied without retroactive effect if the reversal is not immediately occasioned or required by a court decision. The policy of this provision is highly desirable, and in view of the fact that the Bureau of Internal Revenue is now comparatively free from the congestion of cases from the war years, it is believed that this policy may now be extended to cases where the new regulation or Treasury decision is occasioned or required by a court decision. Fundamentally there is no difference in the two cases which can justify the restrictions in section 1108 (a) of the 1926 act. Accordingly, these restrictions have

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[2] In accepting the Senate amendment, the Conference Committee declared (H. Rep. No. 1882, 70th Cong., 1st Sess., p. 22):

"* * * Section 1108 (a) of the revenue act of 1926 permits the commissioner to apply a new regulation or Treasury decision without retroactive effect when the new regulation or Treasury decision is not immediately occasioned by a court decision.

"This desirable policy has been extended by the Senate amendment so as to include all regulations and Treasury decisions whether or not occasioned by a court decision. It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely; and the House recedes."

> been removed in section 605 of the bill. * * *

The final change wrought in these provisions appeared in Section 506 of the Revenue Act of 1934, 48 Stat. 680, which amended Section 1108 (a) of the 1926 Act to read:

> (a) The Secretary, or the Commissioner with the approval of the Secretary, may prescribe *the extent, if any,* to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect. [Italics supplied.]

The discretion vested in the Treasury was now complete. The Treasury could determine not only whether changes in regulations were to be retrospective in all cases, but it was given the further power of declaring the exact extent of retroactivity. Thus, under the new provisions, the Treasury might provide for a change in regulations that would operate retroactively for any designated period. The committee reports leave no doubt whatever that this was the purpose of these provisions. The House Ways and Means Committee unambiguously explained the amended provisions as follows (H. Rep. No. 704, 73d Cong., 2d Sess., p. 38):

> This section amends section 1108 (a) of the Revenue Act of 1926, as amended, so as to permit the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the extent, if any, to which any regulation, Treasury Decision, or ruling relating to internal revenue taxes shall be applied without retroactive effect.

> The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, whether or not it amends a prior regulation or Treasury Decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. *Regulations, Treasury Decisions, and rulings which are merely interpretative of the statute, will normally have a universal application, but in some cases the application of regulations, Treasury Decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury Decisions, and rulings with prospective effect only.* [Italics supplied.]

A similar statement was made by the Senate Finance Committee. S. Rep. No. 558, 73d Cong., 2nd Sess., p. 48.

These provisions, as thus amended by the 1934 Act were incorporated into the Internal Revenue Code as Section 3791 (b) which is involved herein. The history of these provisions plainly shows, we submit, that Congress intended the Treasury to have full and complete discretion to determine to what extent changes in regulations are to operate

retroactively. Nowhere in the legislative history is there the slightest suggestion that the Treasury's discretion was to be limited, in the language of *Helvering* v. *Reynolds Tobacco Co.*, 306 U. S. 110, 116, merely "to correct misinterpretations, inaccuracies, or omissions". The broad sweep of the statutory provisions themselves and the clear and persistent statements appearing in the committee reports afford no support for the limitation imposed upon those provisions by the *Reynolds Tobacco* decision, where the foregoing legislative history was neither fully presented to the Court nor apparently considered by it. Moreover, the 1934, or last amendment to these provisions was not even applicable in that case, because the amendatory regulations were issued (May 2, 1934) prior to the enactment of the Revenue Act of 1934, which became law on May 10, 1934. Finally much of the theory underlying the *Reynolds Tobacco* case has since been rejected by the Court. See *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90; *Helvering* v. *Reynolds*, 313 U. S. 428.

Accordingly, we submit that under Section 3791 (b) of the Code, the Treasury had statutory authority to promulgate an amendment to the regulations that would be applicable here. It should not be assumed that the Treasury will abuse that discretion. Indeed, a recent instance of the Treasury's sense of fairness in applying these provisions may be seen in its action following this Court's decision in *Helvering* v. *Hallock*, 309 U. S. 106. The *Hallock* decision had overruled *Helvering* v. *St. Louis Union Trust Co.*, 296 U. S. 39, and thus invalidated the Treasury

regulations that had previously been adopted to reflect the result in the *St. Louis Union Trust Co.* case. But the Treasury recognized that transfers of property may have been made between the date of the *St. Louis Union Trust Co.* decision (1935) and the *Hallock* decision (1940) in reliance upon those regulations. Accordingly, in promulgating amended regulations to reflect the result of the *Hallock* decision the Treasury has specifically provided that all transfers made during the period between the *St. Louis Union Trust Co.* and *Hallock* decisions are to be governed by the rule of the existing rather than the new regulations. T. D. 5008, 1940-2 Cum. Bull. 286.

In the instant case, the amendment to the regulations was permitted to have retroactive as well as prospective operation, merely to remove any possible obstacle that might otherwise prevent the Court for an unduly long time from adjudicating the validity of the tax upon a pure stock dividend imposed by the statute. (Cf. *Helvering* v. *Gerhardt*, 304 U. S. 405, 422–423.) We are informed by the Treasury that it has no intention of harassing taxpayers with respect to liability for past years, and that if *Eisner* v. *Macomber* is overruled, it intends immediately to recommend to Congress legislation which would relieve taxpayers of any unfair retroactive burden that might result from such overruling, just as it did in the Public Salary Tax Act of 1939 (53 Stat. 574) which protected both state and federal employees from the hardship involved in the retroactive application of the overruling of *Collector* v. *Day*, 11 Wall. 113.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

SYLVIE R. GRIFFITHS,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

WILL R. GREGG,
ALLIN H. PIERCE,
Counsel for the Respondent.

THE COURT PRESS, N. Y. C.

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Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 11) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 20) is reported in 129 F. (2d) 321.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on July 20, 1942 (R. 20). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

I.

Does a stock dividend of common shares upon common shares, where there is no other class of stock outstanding, constitute income within the meaning of the Sixteenth Amendment?

II.

Was such a stock dividend taxable as income under the Revenue Act and Treasury Regulations which were in effect during the year 1939?

III.

Assuming *arguendo* that both of the above questions are answered in the affirmative, what amount should be included in the taxpayer's gross income on account of the stock dividends here involved?

Constitutional Provisions, Statute and Regulations Involved.

The material provisions of the Constitution and most of the material provisions of the Statute and Treasury Regulations are set forth in the Appendix of the Commissioner's Brief (pp. 7-10). Additional provisions deemed material are cited in the Argument *infra*.

Statement.

This case involves an alleged deficiency in income tax for the year 1939, asserted against Sylvie R. Griffiths, the respondent in this court.

The facts of the case are set forth in the petition filed by the taxpayer with the Board of Tax Appeals (R. 3-9). All facts alleged in that petition were admitted by the Commissioner in his answer (R. 10) and the case was submitted for decision upon the pleadings.

The more important facts are summarized in the Board's opinion (R. 11):

> "The Commissioner determined that stock dividends of common shares received by the petitioner in the taxable year upon shares which she owned of exactly the same class and kind, there being no other or different stock outstanding, were income to the extent of their value.
>
> "The determination is reversed."

Argument.

I.

No issue respecting the taxing powers of Congress is presented.

The petition for certiorari suggests that the issue in this case pertains to the power of Congress to tax stock dividends constitutionally and to lay such tax without apportionment. On page 2 of the petition it is stated that the question is whether a stock dividend of the type described "is constitutionally subject to tax without apportionment"; and on page 6 of the petition the first error specified is that the court below erred "in holding that the stock dividends could not constitutionally be subjected to tax."

It is respectfully submitted that such issues are not presented by the record in this case, and that the only questions involved pertain to the construction of the Reve-

nue Act of 1938 and provisions of the Sixteenth Amendment referred to in Section 115 (f) of that statute.

The only tax claimed by the Commissioner in his notice of deficiency herein was additional income tax for the year 1939 (R. 8-9). The taxpayer appealed to the Board of Tax Appeals on three grounds: (1) that the stock dividends in respect of which the Commissioner claimed the additional income tax were not properly includible in gross income; (2) that they did not constitute income to the taxpayer within the meaning of the Sixteenth Amendment; and (3) that, in the alternative, if any amount were includible in gross income in respect of the stock dividends, the amount included by the Commissioner was incorrect (R. 3-4).

All facts alleged in the petition were admitted in the answer and the case was submitted for decision on the pleadings. The Board reversed the Commissioner's determination that the stock dividends "were income to the extent of their value" (R. 11); and the Board's decision was affirmed by the Circuit Court of Appeals in a *per curiam* opinion (R. 20). Thus no issue pertaining to the taxing powers of Congress was raised by the pleadings or decided below. The taxpayer conceded in her brief below, and she also concedes here, that Congress does have power to tax income; and the Sixteenth Amendment expressly provides that taxes on income may be laid without apportionment.

The present case differs from *Eisner* v. *Macomber*, 252 U. S. 189 (1920), in that there the provisions of the applicable statute made it necessary for the Court to consider not only the construction of the term "income" as used in the Sixteenth Amendment but also the power of Congress to tax stock dividends even if they were not income within the meaning of the Amendment. The Revenue Act of 1916, which was involved in the *Macomber*

case, provided in Section 2 (a) (see quotation from the Act set forth in the footnote on page 200 of the *Macomber* case) that a stock dividend "shall be considered income, to the amount of its cash value." In contrast, the Revenue Act of 1938 here involved provides in Section 22 (c) that "distributions by corporations shall be taxable to the shareholders as provided in Section 115"; and, in Section 115 (f) (1) it provides that "a distribution made by a corporation to its shareholders in its stock * * * shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

The present case, therefore, presents no challenge to those holdings in *Eisner* v. *Macomber* which pertain to the power of Congress to tax stock dividends other than as income. The issue is limited to the construction of the Revenue Act of 1938 and the provisions of the Sixteenth Amendment which are expressly referred to in Section 115 (f) of that statute.

II.

The principle that a stock dividend in common stock on common stock is not income within the meaning of the amendment has been long established. There is no conflict of decisions.

In *Eisner* v. *Macomber, supra,* this Court, in a carefully considered opinion which reviewed practically all possible arguments on the subject, decided that a stock dividend distributed by a corporation in its common shares to its then common shareholders, there being no other class of stock outstanding, did not constitute income to the shareholders within the meaning of the Sixteenth Amendment. Soon thereafter, in a series of other

decisions, the Court pointed out the distinction between taxable and non-taxable distributions. *United States* v. *Phellis*, 257 U. S. 156 (1921); *Rockefeller* v. *United States*, 257 U. S. 176 (1921); *Cullinan* v. *Walker*, 262 U. S. 134 (1923); and *Marr* v. *United States*, 268 U. S. 536 (1925). At a still later date, in *Koshland* v. *Helvering*, 298 U. S. 441 (1936), the Court specifically defined the application of the rule of the *Macomber* case as follows (pp. 445-446):

> "Under our decisions the payment of a dividend of new common shares, conferring no different rights or interests than did the old,—the new certificates, plus the old, representing the same proportionate interest in the net assets of the corporation as did the old,—does not constitute the receipt of income by the stockholder. On the other hand, where a stock dividend gives the stockholder an interest different from that which his former stockholdings represented he receives income."

For more than twenty-two years the *Macomber* case has stood as the controlling authority on the taxability of stock dividends. Its basic rule has been recognized uniformly by the courts, the Board of Tax Appeals, the administrative authorities and the Congress. Corporations have changed their capital structures and determined the amounts of their undistributed surpluses in accordance with the rule. And, undoubtedly, thousands of shareholders have computed their income tax liabilities and filed their tax returns in reliance upon what they believed was a settled principle of law.

There is no conflict of decisions. The cases of *Helvering* v. *Sprouse*, October Term, 1942, No. 22, and *Strassburger* v. *Helvering*, October Term, 1942, No. 66, pertain

only to the applicability of the rule of the *Macomber* and *Koshland* cases to the particular stock dividends there involved; in neither case did the court below question the soundness of the basic rule as applied to facts like those here present.

It is respectfully submitted that if any change in the long established rule of the *Macomber* case is necessary or desirable, such change should be made by the Congress.

III.

Congress, in enacting the Revenue Act of 1938, did not impose income tax upon stock dividends of the type here involved. Treasury regulations in effect during the taxable year stated that such stock dividends were not taxable.

Eisner v. *Macomber, supra,* was decided March 8, 1920. Soon thereafter Congress enacted the Revenue Act of 1921 which provided in Section 201 (d): "A stock dividend shall not be subject to tax * * *." A similar exemption was provided in all subsequent Revenue Acts applicable down to the year 1936. Section 201 (f) Rev. Acts 1924 and 1926; Section 115 (f) Rev. Acts 1928, 1932 and 1934.

On May 18, 1936 this Court decided *Koshland* v. *Helvering, supra,* in which it said (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921."

Thereafter, on June 22, 1936, there was enacted the Revenue Act of 1936, which provided:

"115 (f) STOCK DIVIDENDS—

"(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

It will be observed that the above statute is worded in the negative and that it does not provide that every stock dividend is taxable. To the contrary, the succeeding paragraph (Section 115 (f) (2)) refers to a distribution of stock "of a class which * * * would be exempt from tax under paragraph (1)". The construction intended to be applied to the statute is shown in the following discussion had in the House of Representatives at the time the bill was pending (Cong. Rec., Vol. 80):

"Mr. Vinson of Kentucky. * * * Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.

"The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. * * *

"It is our purpose to allow as a dividend credit distribution in stock of corporations, or in rights to

acquire stock of a corporation which constitutes income to the shareholder within the meaning of the sixteenth amendment. In no sense is this an attack upon the Eisner against Macomber decision * * * (pp. 6214-15).

* * * * * * * * *

"Mr. Vinson of Kentucky. * * * The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder" (p. 6309).

* * * * * * * * *

"Mr. Treadway. * * * I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

"Mr. Vinson of Kentucky. That is correct" (p. 6310).

The above discussion indicates that Congress acquiesced in the rule of the *Macomber* and *Koshland* cases and did not intend to tax stock dividends of the character here involved. The implication is clear that such distributions were not intended to be recognized either as "dividends" or as "income" within the meaning of the statute.

The Treasury Department adopted this construction in promulgating Regulations 94 relating to the 1936 Act. In Article 115-7, it stated:

"A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old

> representing the same proportionate interest in the net assets of the corporation as did the old."

It then inserted in the regulation "Example (2)" to illustrate the character of such stock dividends, and concluded as follows:

> "The stock so distributed does not constitute a taxable stock dividend to the shareholders."

In 1938, while the foregoing Regulations were in force and such construction was being applied, Congress re-enacted the provisions of section 115 (f) of the 1936 Act, without change, as section 115 (f) of the Revenue Act of 1938. The Treasury Department then promulgated Regulations 101, relating to the new Act, and included therein, as Article 115-7, the precise provisions of the corresponding article of Regulations 94.

This regulation relating to the Revenue Act of 1938, which is the Act governing the present case, continued in full force and effect until January, 1942, when it was amended so as to delete the statements above mentioned (Petn. for Cert., pp. 9-10). The amendment was made subsequent to the issuance of the deficiency notice herein (R. 8), more than two years after the stock dividends here involved had been declared and distributed, and nearly two years after the time the respondent's tax return was filed.

It is respectfully submitted that the intention of the Congress in regard to the taxation of stock dividends was clear and was correctly embodied in the Treasury Regulations construing section 115 (f) of the 1936 Act, and that when Congress re-enacted the provisions of that section as part of the 1938 Act it must be taken to have approved the administrative construction and thereby to have given it the force of law. *Helvering* v. *R. J.*

Reynolds Tobacco Co., 306 U. S. 110, 115 (1939). The attempt of the Treasury to change the existing law, retroactively, by amending its regulations in January 1942 should not be approved.

CONCLUSION.

The petition for certiorari should be denied.

Respectfully submitted,

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November 10, 1942.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SYLVIE R. GRIFFITHS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SYLVIE R. GRIFFITHS,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals (R. 8-9) is unreported. The *per curiam* opinion of the Circuit Court of Appeals for the Second Circuit (R. 14) is reported in 129 F. (2d) 321.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered July 20, 1942 (R. 14). The petition for writ of certiorari was filed October 20, 1942, and was granted November 23, 1942 (R. 15). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Questions Presented.

I.

Was a stock dividend of common shares upon common shares, where there was no other class of stock outstanding, taxable as income under the Internal Revenue Code and Treasury Regulations in effect during the year 1939?

II.

Does such a stock dividend constitute income within the meaning of the Sixteenth Amendment?

III.

Was the retroactive amendment of Section 19.115-7 of Treasury Regulations 103, valid?

Constitutional Provisions, Statutes and Regulations Involved.

The provisions of the Constitution, Statutes and Treasury Regulations involved are set forth in the Appendix (*infra*, p. 25).

Statement.

This case involves an alleged deficiency in income tax for the year 1939 asserted against Sylvie R. Griffiths, the respondent in this Court.

The more important facts are summarized in the opinion of the Board of Tax Appeals (R. 8-9):

> "This proceeding assails a determination of a deficiency of $9.60 in petitioner's income tax for 1939.

It is submitted upon the pleadings under Rule 30. The facts alleged in the petition are all admitted in the answer.

"The Commissioner determined that stock dividends of common shares received by the petitioner in the taxable year upon shares which she owned of exactly the same class and kind, there being no other or different stock outstanding, were income to the extent of their value.

"The determination is reversed."

The Board's decision that there was no deficiency in income tax (R. 9) was affirmed *per curiam* by the court below (R. 14).

The facts alleged by the taxpayer in her petition to the Board (R. 1-7) and admitted by the Commissioner in his answer (R. 8) are as follows:

"Standard Oil Company (New Jersey) is a corporation organized and existing under the laws of the State of New Jersey. Throughout the year 1939 its total authorized capital stock was $750,000,000 divided into 30,000,000 shares of the par value of $25 each, of which there were issued and outstanding on January 1, 1939, approximately 26,500,000 shares of the aggregate par value of approximately $662,500,000. In addition, the corporation had on January 1, 1939, a capital surplus per books of approximately $66,500,000 and earned surplus and undivided profits per books of approximately $130,000,000. The amounts represented by said outstanding capital stock, capital surplus, earned surplus, and undivided profits were invested in assets or otherwise used by the corporation for the purposes of its business.

"All of the shares of the capital stock of said corporation which were outstanding at any time during the year 1939 were of the same class and character;

and the rights and interest of the holder of each share thereof were identical with those of the holder of every other share.

"On May 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on June 15, 1939, there be distributed to the stockholders of record at the close of business on May 16, 1939, additional shares of the capital stock of the corporation on the basis of two (2) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

"On November 1, 1939, the board of directors of Standard Oil Company (New Jersey) adopted resolutions whereby they directed that on December 15, 1939, there be distributed to the stockholders of record at the close of business on November 15, 1939, additional shares of the capital stock of the corporation on the basis of three (3) shares of such stock for each two hundred (200) shares of the capital stock of the corporation held on said record date, and that

for each additional share of the capital stock so issued the earned surplus account be charged with $27.50 and the capital stock account be credited with the par value of such share, namely, $25.00, and the capital surplus account be credited with $2.50. In accordance with these directions, the transfers from the earned surplus account to the capital stock account and the capital surplus account were made, and the new shares of stock were issued against the amount transferred to the capital stock account, and these new shares were divided among the stockholders on the date and in the proportions above described. The total amount so transferred from the earned surplus account to the capital stock account and the capital surplus account was less than the amount of the earnings and profits accumulated by the corporation subsequent to February 28, 1913.

"The additional shares of the capital stock of Standard Oil Company (New Jersey) so distributed as stock dividends on June 15, 1939, and December 15, 1939, respectively, were of precisely the same class and character as the shares of the capital stock in respect of which the distributions were made. In each instance, the proportionate interest of each shareholder in the corporation immediately after the issuance and distribution of the new shares was the same as his former interest. In neither instance did any shareholder have a right to an election or option to receive cash or other property in lieu of his proportion of the additional shares of the capital stock issued and distributed.

"On May 16, 1939, and continuously to the time of the distribution of said stock dividend on June 15, 1939, the petitioner was the owner and holder of 101 shares of the capital stock of Standard Oil Company (New Jersey) of which her total adjusted cost basis for computing gain or loss for federal income tax purposes was $5,750.36. On June 15,

1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.01 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on June 15, 1939, immediately after the receipt of said additional shares by the petitioner, was $42.50; and the fair market value at that time of the 102.01 shares then held by the petitioner was $4,335.43, including the fair market value of said 1.01 additional shares which was $42.93.

"The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.01 additional shares was $25.25; and the amount transferred from its earned surplus account to its capital surplus account in connection with the issuance of said shares was $2.525.

"From June 15, 1939, to the time of the distribution of the said stock dividend on December 15, 1939, the petitioner was the owner and holder of 102.01 shares of the capital stock of Standard Oil Company (New Jersey). On December 15, 1939, she received in respect of said shares, as her proportion of the stock dividend distributed on that date, 1.53 additional shares of the capital stock of that corporation. The fair market value of each share of the capital stock of said corporation on December 15, 1939, immediately after the receipt of said additional shares by the petitioner was $43.1875; and the fair market value at that time of the 103.54 shares then held by the petitioner was $4,471.63, including the fair market value of said 1.53 additional shares which was $66.08.

"The amount transferred by Standard Oil Company (New Jersey) from its earned surplus account to its capital stock account in connection with the issuance of said 1.53 additional shares was $38.25; and the amount transferred from its earned surplus

account to its capital surplus account in connection with the issuance of said shares was $3.825.

"None of said additional shares of the capital stock of Standard Oil Company (New Jersey) received by the petitioner as stock dividends have been cancelled or redeemed by the corporation. None of said shares were sold by the petitioner during the taxable year here involved.

"In her federal income tax return for 1939, the petitioner did not include in her gross income any amount in respect of the additional shares of the capital stock of Standard Oil Company (New Jersey) which she received as stock dividends on June 15, 1939, and December 15, 1939, respectively.

"At all times here material, the petitioner kept her books of account and made her federal income tax returns in accordance with the cash receipts and disbursements method of accounting and on the calendar year basis."

Argument.

I.

The Internal Revenue Code does not impose income tax upon stock dividends of the type here involved. The Treasury Regulations in force during the taxable year 1939 stated that such stock dividends were not taxable.

The history of the taxation of stock dividends as income, since the adoption of the Sixteenth Amendment, is briefly as follows:

The Revenue Act of 1913 (*infra*, p. 25) did not specifically refer to dividends payable in stock. It levied a tax upon "the entire net income" of every citizen residing at home or abroad and of every person residing in

the United States though not a citizen. It further provided that the net income of a taxable person should include "gains, profits, and income derived from * * * dividends * * *, or gains or profits and income derived from any source whatever * * *."

In *Towne* v. *Eisner*, 245 U. S. 418 (1918), the question arose as to whether the distribution pro rata to stockholders of an additional amount of stock created by the transfer to capital account of surplus profits earned before January 1, 1913, was a taxable dividend. The Court in a unanimous opinion written by Mr. Justice Holmes concluded that the dividend was capital. It quoted, with approval, from *Gibbons* v. *Mahon*, 136 U. S. 549, 559, 560:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. * * * The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones."

In the Revenue Act of 1916 (*infra*, pp. 25-26) Congress attempted to tax stock dividends specifically, and provided that the term "dividends" should be held to mean any distribution made by a corporation out of its earnings or profits accrued since March 1, 1913, and payable to its shareholders "whether in cash or in stock of the corporation" and that a stock dividend should be "considered income, to the amount of its cash value".

Eisner v. *Macomber*, 252 U. S. 189 (1920), involved the question of whether these provisions of the 1916 Act were applicable to the fifty per cent. stock dividend declared by the Standard Oil Company of California in January 1916.

The majority opinion of the Court held that such a stock dividend was not income and said in part (p. 207):

> "Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*', that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description."

In the Revenue Act of 1921, Sec. 201 (d) (*infra*, p. 26) Congress accepted the principle that a stock dividend was not income and provided specifically, "a stock dividend shall not be subject to tax * * *."

A consideration of this and other provisions of the Revenue Act of 1921 shows that this acceptance of the nontaxability of stock dividends was not merely an acquiescence by Congress in the decision of *Eisner* v. *Macomber*, but part of a plan to distinguish, and tax on different bases, recurring income from gains or profits derived from the sale or other disposition of capital assets. In the earlier revenue acts capital gains had been treated as fully taxable. This resulted in taxing in a single year profits that had accrued over a period and interfered with normal economic transactions. Stockholders were unwilling to dispose of their securities or even to vote in favor of corporate reorganizations for fear that a taxable gain might be realized. As the result, an entirely new approach to the taxation of capital profits was incorporated in the Revenue Act of 1921. Gains and losses from the sale or other disposition of capital assets were segregated from ordinary income and were taxed at different rates (Sec. 206 (b), *infra*, p. 26). Congress went further and defined four types of transactions in which gain or loss would not

be recognized for tax purposes (Sec. 202 (c) *infra*, p. 26). These were: (1) an exchange of property held for investment or productive use in trade or business for property of a like kind or use; (2) an exchange of stock or securities for stock or securities in connection with a reorganization; (3) an exchange in which property was transferred to a corporation and the transferror was in control of the corporation immediately after the transfer; and (4) a compulsory or involuntary conversion of property into other property similar or related in service or use to the property so converted. In subsequent revenue acts these provisions were amplified and extended.

The purpose of Congress in making these changes is set forth in the report of the Ways and Means Committee (67 Cong. 1st Sess., H. Rept. 350, p. 10):

> "Under existing law the presumption is in favor of taxation. The proposed bill modifies that presumption by providing that on an exchange of property for property no gain or loss shall be recognized unless the property received in exchange has a definite and readily realizable market value; and specifies in addition certain classes of exchanges on which no gain or loss is recognized even if the property received in exchange has a readily realizable market value.
>
> "The preceding amendments, if adopted, will, by removing a source of grave uncertainty, not only permit business to go forward with the readjustments required by existing conditions but will also considerably increase the revenue by preventing taxpayers from taking colorable losses in wash sales and other fictitious exchanges."

The provision of the Revenue Act of 1921, specifically exempting stock dividends was reinacted as part of all revenue acts in force prior to the year 1936 (*infra*, p. 26).

On May 18, 1936, this Court decided *Koshland* v. *Helvering*, 298 U. S. 441, in which it said (p. 445):

> "Although *Eisner* v. *Macomber* affected only the taxation of dividends declared in the same stock as that presently held by the taxpayer, the Treasury gave the decision a broader interpretation which Congress followed in the Act of 1921."

Thereafter, on June 22, 1936, there was enacted the Revenue Act of 1936, which provided:

> "115 (f) Stock Dividends—
>
> "(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

It will be observed that this provision is worded in the negative and clearly contemplates that some stock dividends do not constitute income. The petitioner contends that this phraseology was adopted only out of respect for this Court and that the true intent of Congress was to tax all stock dividends to the limit of its constitutional power. This construction renders meaningless various other provisions of the statute (see Sec. 115 (f) (2), *infra*, p. 30; Sec. 115 (h) (2), *infra*, p. 30; and Sec. 115 (j), *infra*, p. 30). Petitioner's argument does violence to the well established principle of statutory construction that effect must be given, if possible, to every provision of the law.

The true purpose of the statute is shown by the discussion had in the House of Representatives at the time the bill was pending (Cong. Rec., Vol. 80, pp. 6214-15, 6309, 6310). Mr. Doughton, Chairman of the Ways and Means Committee introduced the bill and in the course of the

debate left to Mr. Vinson of Kentucky, a member of the Committee, the explanation of various detailed provisions:[1]

(pp. 6214-15)

"Mr. Vinson of Kentucky. * * * Coming now to stock dividends, this is a field that has more or less been surrounded with mystery. Existing law provides that no tax shall be levied upon stock dividends. We strike that from this bill. There are innumerable types of stock dividends that are taxable under the Constitution and under the celebrated case of Eisner versus Macomber.

"The kind of securities issued and the change in the proportion of ownership of a person in a corporation are the determining factors as to whether or not it is taxable income under the sixteenth amendment. * * *

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1 In *Wright* v. *Vinton Branch*, 300 U. S. 440 (1937), the Court in an opinion delivered by Mr. Justice Brandeis said (p. 463):

"Since the language of the Act is not free from doubt in the particulars mentioned, we are justified in seeking enlightenment from reports of Congressional committees and explanations given on the floor of the Senate and House by those in charge of the measure."

In support of this statement the Court inserted a footnote, reading as follows:

"Where the meaning of legislation is doubtful or obscure, resort may be had in its interpretation to reports of Congressional committees which have considered the measure. (*McLean* v. *United States*, 226 U. S. 374, 380; *Tagg Bros. & Moorhead* v. *United States*, 280 U. S. 420, 435); to exposition of the bill on the floor of Congress by those in charge of or sponsoring the legislation, (*Duplex Printing Press Co.* v. *Deering*, 254 U. S. 443, 475; *Richbourg Motor Co.* v. *United States*, 281 U. S. 528, 536); to comparison of successive drafts or amendments of the measure, (*United States* v. *Pflisch*, 256 U. S. 547, 551; *United States* v. *Great Northern Ry. Co.*, 287 U. S. 144, 155); and to the debates in general in order to show common agreement on purpose as distinguished from interpretation of particular phraseology. (*Federal Trade Comm'n* v. *Raladam Co.*, 283 U. S. 643, 650; *Humphrey's Executor* v. *United States*, 295 U. S. 602, 625)."

"It is our purpose to allow as a dividend credit distribution in stock of corporations, or in rights to acquire stock of a corporation which constitutes income to the shareholder within the meaning of the sixteenth amendment. In no sense is this an attack upon the Eisner against Macomber decision. * * *

"With permission of the chairman, I insert herewith memorandum furnished me by Mr. Kent, Acting General Counsel of the Bureau of Internal Revenue:

'Reference is made to the request of Representative Vinson for a compilation of cases involving the taxability as income of stock dividends.

In the following cases the stock dividends or rights received were considered a mere change of form and not the realization of income and, therefore, were not taxable.

Towne v. *Eisner* (245 U. S. 418);
Eisner v. *Macomber* (252 U. S. 189);
Miles v. *Safe Deposit & Trust Co. of Baltimore* (259 U. S. 247, aff'g 273 Fed. 822);
United States v. *Mellon* (279 Fed. 91, aff'd 281 Fed. 645);
United States v. *Davison* (1 Fed. (2d) 465, aff'd 9 Fed. (2d) 1022, cert. den. 271 U. S. 670);
Michaels v. *McLaughlin* (80 Fed. (2d) 959);
Teehan v. *West* (25 Fed. (2d) 884);
Irving v. *United States* (44 Fed. (2d) 246);
Jackson v. *Commissioner* (51 Fed. (2d) 650);
Pearl B. Brown v. *Commissioner* (69 Fed. (2d) 602, aff'g 26 B. T. A. 901, cert. den. 293 U. S. 570);
Frances. E. Clark (77 Fed. (2d) 89, aff'g 28 B. T. A. 1225);
Commissioner v. *Kashland* (81 Fed. (2d) 641, cert. granted 56 Sup. Ct. 669);
Theresa Zellerbach et al. (2 B. T. A. 1076);

W. Q. Wright v. *Commissioner* (10 B. T. A. 806);
George T. Smith v. *Commissioner* (21 B. T. A. 782);
T. I. Hare Powel v. *Commissioner* (27 B. T. A. 55).

In the following cases the dividends received were distinguished from stock dividends and could, therefore, be treated as realized, taxable income.

Peabody v. *Eisner* (247 U. S. 347) (dividend of preferred and common stock of a different corporation).

Doerschuck v. *United States* (274 U. S. 739) (dividend of debenture bonds of the same corporation).

Vogt Machine Co. v. *United States* (39 Fed. (2d) 986, certiorari denied, 282 U. S. 861). (Company declared cash dividend, bearing interest at 4 percent. to be paid 6 and 12 months thereafter in stock to be issued.)

United States v. *Fuller* (42 Fed. (2d) 471). (Dividend of the corporation's own bonds.)

Tillotson Manufacturing Co. v. *Commissioner* (76 Fed. (2d) 189, affirming 27 B. T. A. 913). (Accrued dividends on preferred stock paid in common stock of the corporation, some preferred-stock holders, however, accepting cash instead.)

Eugene E. Paul et al. v. *Commissioner* (2 B. T. A. 150). (Cash dividend declared. Six days later new stock issue was authorized, and stockholders agreed that dividend checks would be used to purchase the newly issued common and preferred stock.)

W. J. Hunt v. *Commissioner* (5 B. T. A. 356). (Prior to declaration of cash dividends, stockholders agreed among themselves to apply checks toward purchase of previously issued stock.)

Luthe Hardware Co. v. *Commissioner* (6 B. T. A. 53). (Cash dividend declared, but holders of 294

out of 300 shares held checks until new stock was issued and then endorsed checks over for purchase of new shares.)

J. E. Brading v. *Commissioner* (17 B. T. A. 429). (New stock issued to stockholders of close corporation after passage of resolution that debt thus incurred was to be liquidated by application of dividends due, or to become due, or as the board of directors might direct. A dividend was then declared and applied toward payment of the price of the new stock.)

Margaret B. Payne v. *Commissioner* (19 B. T. A. 1305). (Cash dividend was declared, and checks were issued, but, in accordance with previous agreement among stockholders that this dividend was to be treated as a stock dividend, the stockholders used it to purchase a new issue of stock.)

Joseph Paper v. *Commissioner* (29 B. T. A. 523). (Resolution gave stockholders option to take dividends in cash or in preferred stock.)

L. Elmer Wood et al. v. *Commissioner* (29 B. T. A. 731). (Resolution provided that accrued dividends on 6-percent preferred stock should be paid from net earnings, but preferred-stockholders were given opportunity to use dividends for purchase of entire new issue of 7-percent preferred.)

• • • • • • • •

(p. 6309)

"Mr. Vinson of Kentucky. • • • The proposed plan does not change the law and does not in the slightest degree strike at the decision of the Supreme Court in the case of Eisner and Macomber in respect of a stock dividend where there is no change in the proportion of ownership by the shareholder."

• • • • • • • •

(p. 6310)

"Mr. Treadway. • • • I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

"Mr. Vinson of Kentucky. That is correct."

The Treasury Department adopted this construction in promulgating Regulations 94 relating to the 1936 Act. In Article 115-7 (*infra*, pp. 31-33) it stated:

"A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old."

It then inserted in the regulation three examples to illustrate the application of the tax to different types of stock dividends. The second example involved a case on all fours with the case at bar, that is a dividend in common stock distributed *pro rata* to common shareholders, there being only one class of authorized stock. This example concluded with the statement (*infra*, p. 33):

"The stock so distributed does not constitute a taxable stock dividend to the shareholders."

In 1938, while the foregoing Regulations were in force and such construction was being applied, Congress reenacted the provisions of Section 115 (f) of the 1936 Act, without change, as Section 115 (f) of the Revenue Act of 1938. The Treasury Department then promulgated Regulations 101, relating to the new act, and included, as Article 115-7, the precise provisions of the corresponding article of Regulations 94. In 1939, the provisions of Section 115 (f) of the Revenue Acts of 1936 and 1938

were adopted as Section 115 (f) of the Internal Revenue Code; and the Treasury Department then repromulgated the provisions of Article 115-7 of Regulations 94 and 101 as Section 19.115-7 of Regulations 103.

This regulation relating to the Internal Revenue Code, which governs the present case, continued in full force and effect until November 15, 1940, when it was amended so as to delete the statements above mentioned. (T. D. 5020, *infra*, p. 33). The amendment was made more than one year after the stock dividends here involved had been declared, and eight months after the respondent's tax return was filed.

It is now asserted that Congress by amending the Revenue Act of 1936 attempted to tax stock dividends to the full extent permitted by the Constitution. We submit that the legislative history shows that Congress had no such intention. On the contrary, Congress acquiesced in the holding of *Eisner* v. *Macomber* that a true stock dividend, that is, a dividend where additional shares of common stock are created by a transfer of surplus to capital account and are distributed *pro rata* to common stockholders, did not represent income. By the amendment Congress attempted to tax only those dividends paid in stock which resulted in changing the proportionate interests of the shareholders. The statements made in the course of the debate on the bill in Congress, quoted above, coupled with the Treasury Regulations which were published contemporaneously, show beyond peradventure of a doubt that Congress did not intend to tax a true stock dividend.

A final proof lies in the fact that Standard Oil Company of New Jersey on December 15, 1938, distributed a stock dividend comparable in every respect to those involved in the case at bar, and the Treasury Depart-

ment issued a special ruling in a letter addressed to the corporation dated December 29, 1938, which read in part (1939 C. C. H. Federal Tax Service, Vol. 3, par. 6072):

> "Since you had but one class of authorized stock, the distribution of additional shares to your stockholders did not result in the receipt by them of income within the meaning of the Sixteenth Amendment to the Constitution; *Eisner* v. *Macomber*, 252 U. S. 189, Treasury Decision 3010, 3 C. B. 25 (1920)."

This ruling was issued by the Treasury Department after the enactment of the Revenue Act of 1938 in respect of a stock dividend that was taxable under that Act which, so far as material, is identical with the applicable statute in the present case.

II.

Eisner v. _Macomber_ is directly in point and was correctly decided. No valid reason has been suggested for overruling it and the many other cases decided on its authority.

The petition for the writ of certiorari herein states that this proceeding is a test case designed to challenge directly the authority of *Eisner* v. *Macomber*, *supra*. For the reasons pointed out above we do not believe that the Internal Revenue Code taxed a true stock dividend as income. Nevertheless, if this Court should conclude otherwise and undertake to reexamine the *Macomber* case we believe it will find that it was correctly decided.

The issue in the *Macomber* case was whether a true stock dividend represented income and was therefore a proper subject of taxation under the Sixteenth

Amendment. There is no need to repeat the elaborate arguments considered and disposed of in that case. They are too well known to require elaboration. The *ratio decidendi* of the majority of the Court has already been quoted (p. 9, *supra*) and is based on the sound principle that "income" cannot include a mere change of form that does not add in any respect to the rights or privileges of the stockholder and does not in any way change his proportionate interest in the corporate enterprise.

The *Macomber* case has been the controlling authority in regard to the taxability of stock dividends for more than twenty-two years. It has been cited with approval in numerous cases. It has been distinguished in cases involving reorganizations[2] and distributions which were not true stock dividends[3], but its basic proposition that a true stock dividend does not constitute "income" has been uniformly upheld. Also on its authority depends the whole line of cases holding that the distribution of rights to subscribe to securities of the issuing corporation do not constitute income[4]. If *Eisner* v. *Macomber* is overruled these cases also must fall.

The petition for the writ of certiorari called attention to the fact that two other cases involving the taxability of stock dividends are now pending before this Court (*Helvering* v. *Sprouse*, No. 22, Present Term, and *Strassburger* v. *Helvering*, No. 66, Present Term). The brief in the latter case asserts (pp. 22, 29) that the effect

2 See *United States* v. *Phellis*, 257 U. S. 156 (1921); *Rockefeller* v. *United States*, 257 U. S. 176 (1921); *Cullinan* v. *Walker*, 262 U. S. 134 (1923); and *Marr* v. *United States*, 268 U. S. 536 (1925). But note, however, the provisions of the Revenue Act of 1921 making exchanges in connection with reorganizations non-taxable transactions.

3 See *Koshland* v. *Helvering*, 298 U. S. 441 (1936); *Helvering* v. *Gowran*, 302 U. S. 238 (1937); and *Helvering* v. *Pfeiffer*, 302 U. S. 247 (1937).

4 See *Miles* v. *Safe Deposit Co.*, 259 U. S. 247 (1922) and *Palmer* v. *Commissioner*, 302 U. S. 63 (1937).

of the adoption of the Sixteenth Amendment was to reverse the decision of this Court in *Pollock* v. *Farmers' Loan and Trust Company*, 157 U. S. 429, 158 U. S. 601. On the assumption that the *Pollock* case is no longer law, it suggests that this Court might conclude that Article I of the Constitution granted Congress an unlimited power of taxation, subject only to the requirements of uniformity in respect of duties, imposts and excises and of apportionment among the several states in the case of capitation and taxes on real estate (p. 18). The conclusion is irresistible that the petitioner hopes to review in this proceeding the whole line of authority governing the taxing power of the Federal government.

These issues are irrelevant. The case at bar involves only the question of whether the Internal Revenue Code taxes true stock dividends as income and whether a true stock dividend is income within the meaning of the Sixteenth Amendment.

The *Pollock* case was not reversed by the adoption of the Sixteenth Amendment. It was, in fact, affirmed because Congress accepted the conclusion of this Court that a tax on the income of property was a direct tax within the meaning of the Constitution and therefore subject to apportionment, and proposed an amendment designed to give the Federal government a limited power to impose "taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration".

The brief in the *Strassburger* case also refers (pp. 22, 28) to the Civil War income tax acts and states that stock dividends were then subjected to tax and that even the earnings and profits of corporations were taxed to shareholders, irrespective of whether they had been distributed. These issues are likewise irrelevant, but we respectfully call the attention of the Court to the fact that the Civil War in-

come tax laws did not have the effect that these brief statements would seem to imply. The income tax law of 1864 (c. 173, 13 Stat. 281, 283, 284) imposed in effect two different types of taxes. In the case of banks, trust companies, savings institutions and fire, marine, life, and inland insurance companies, and also in the case of railroads and canal, turnpike, canal navigation and slack water companies, a tax was imposed upon the company and was measured by a percentage of certain types of interest and all dividends in scrip or money paid to stockholders, policyholders or depositors as part of the earnings, and by a like percentage of any undistributed sums added to surplus and other accounts. These taxes were payable by the corporation, and the income distributed to the individual taxpayers was excluded in computing their incomes. In the case of all other corporations and in the case of partnerships, the earnings were taxed directly to the shareholders or partners even if not distributed. It is not difficult to find the reason for this differentiation. The companies subjected to tax were those requiring large capital and which were apt to have a large number of shareholders. The companies exempted from tax were principally private enterprises which in many instances had originally been partnerships. In effect, therefore, the Civil War income tax statutes were analogous to the revenue acts passed after the enactment of the Sixteenth Amendment in that Congress adopted a reasonable classification and in some instances imposed an income tax liability on an organization as an entity, and in others disregarded the legal entity and taxed the beneficial interest directly to the owner.

Without attempting to catalogue all the cases in which the revenue acts have disregarded a legal entity or taxed as an entity organizations that had no separate legal existence, it will, we believe, be sufficient to point out that

unincorporated associations and trusts that are analogous to corporations in their organization have been taxed as corporations, and estates in process of administration and testamentary and *inter vivos* trusts have been taxed as individual taxpayers. On the other hand, the existence of a corporate entity has been disregarded in the case of personal service corporations under the excess-profits tax law of 1917, personal holding companies under some of the later revenue acts, and corporations formed or availed of for the purpose of avoiding the imposition of the surtax. No doubt exists as to the power of Congress to make such reasonable classifications, and we cannot believe that *Eisner* v. *Macomber* has prevented Congress, as the petitioner suggests, from adopting the general principle of taxing to shareholders the undistributed earnings of corporations. There is not the slightest evidence that Congress ever had any such intention.

III.

Treasury Decision 5020, promulgated on November 15, 1940, amending Treasury Regulations 103 is invalid as an attempt to extend retroactively the scope of the Internal Revenue Code.

Section 62 of the Internal Revenue Code (*infra*, p. 27) provides as follows:

> "The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter."

Pursuant to the power thereby granted, the Commissioner of Internal Revenue published Regulations 103 on January 29, 1940. Section 19.115-7 of these Regulations provided specifically that a true stock dividend was not

taxable. On November 15, 1940, by T. D. 5020 (*infra*, p. 33) this section of Regulations 103 was amended by deleting the reference to non-taxable stock dividends and the examples. It is now asserted that as a result of this amendment the stock dividends received by the respondent in 1939 were taxable as income to the extent of their market value when received. We submit that this retroactive amendment is invalid.

The situation is in all respects identical with the facts considered by this Court in *Helvering* v. *Reynolds Co.*, 306 U. S. 110 (1939). In that case, as in the case at bar, Congress reenacted in identical words a provision of a preceding revenue act after the Commissioner had published regulations construing the law. It was held that the subsequent retroactive amendment was invalid, and this court said (p. 116):

> "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed."

To the same effect see *Rasquin* v. *Humphreys*, 308 U. S. 54, 56 (1939). See also *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90 (1939); *Helvering* v. *Reynolds*, 313 U. S. 428 (1941).

It should be noted also that Section 19.115-7 of Regulations 103, as originally promulgated, was the same as Article 115-7 of Regulations 101 which had been promulgated in respect of the Revenue Act of 1938, and Article 115-7 of Regulations 94 promulgated in respect of the Revenue Act of 1936. The statutory provisions to which these several regulations referred were identical. Regulations 94 were promulgated before Congress reenacted as

part of the Revenue Act of 1938 the precise provision of Section 115 (f) of the Revenue Act of 1936. If the enactment of the Internal Revenue Code in 1939 is to be treated as a new Revenue Act and not merely as a codification of existing law, then the sections here in question were twice reenacted while the applicable Treasury Regulations specifically provided that a true stock dividend was not taxable.

The vice of Treasury Regulations which upset established practices is apparent from the present case. At the time the stock dividends in question were distributed they were specifically exempt from tax. At the time the respondent prepared and filed her income tax return the same situation existed. Nearly one year later, by an amended regulation, the respondent is charged with tax liability. She and all other taxpayers who received stock dividends in 1939 and subsequent years will be subject to the assessment of deficiencies if this amended regulation is upheld, and this Court should, as the petitioner suggests, overrule the *Macomber* case.

CONCLUSION.

The judgment below should be affirmed.

Respectfully submitted,

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APPENDIX.

Constitution of the United States:

Sixteenth Amendment.—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

Revenue Act of 1913, c. 16, 38 Stat. 114, 166-167:

Section II.

A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade or profession carried on in the United States by persons residing elsewhere.

* * * * * * * * *

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from * * * dividends * * *, or gains or profits and income derived from any source whatever * * *.

Revenue Act of 1916, c. 463, 39 Stat. 756:

Income Defined.

Sec. 2. (a) That, subject only to such exemptions and deductions as are hereinafter allowed, the net in-

come of a taxable person shall include gains, profits, and income derived from * * * dividends * * *: *Provided*, That the term "dividends" as used in this title shall be held to mean any distribution made or ordered to be made by a corporation * * * out of its earnings or profits accrued since March first, nineteen hundred and thirteen, and payable to its shareholders, whether in cash or in stock of the corporation * * *, which stock dividend shall be considered income, to the amount of its cash value.

Revenue Act of 1921, c. 136, 42 Stat. 227:

Sec. 201. (d) A stock dividend shall not be subject to tax * * *.

[This provision was reenacted as part of all revenue acts in force prior to the year 1936:

R. A. 1924, c. 234, 43 Stat. 253, sec. 201 (f);
R. A. 1926, c. 27, 44 Stat. 9, sec. 201 (f);
R. A. 1928, c. 852, 45 Stat. 791, sec. 115 (f);
R. A. 1932, c. 209, 47 Stat. 169, sec. 115 (f);
R. A. 1934, c. 277, 48 Stat. 680, sec. 115 (f)]

Sec. 202. (c). For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—[Here is set forth a description of the transactions on which no gain or loss is recognized.]

Sec. 206. (b) In the case of any taxpayer (other than a corporation) who for any taxable year derives a capital net gain, there shall (at the election of the taxpayer) be levied, collected and paid, in lieu of the taxes imposed by sections 210 and 211 of this title, a

tax determined as follows: [Here is prescribed the method of computation and the rate of tax.]

Revenue Act of 1936, c. 690, 49 Stat. 1648:

[The material provisions of the Revenue Act of 1936, except for minor variations not here material, are the same as the corresponding provisions of the Internal Revenue Code, hereinafter set forth.]

Revenue Act of 1938, c. 289, 52 Stat. 447:

[The material provisions of the Revenue Act of 1938, except for minor variations not here material are the same as the corresponding provisions of the Internal Revenue Code, hereinafter set forth.]

Internal Revenue Code, 53 Stat. 1:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dividends * * *.

* * * * * * * *

(c) *Distributions by corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * * * * *

SEC. 62. RULES AND REGULATIONS.

The Commissioner, with the approval of the Secretary, shall prescribe and publish all needful rules and regulations for the enforcement of this chapter.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * * *

(2) *Stock for stock in same corporation.*—No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * * * * *

(g) *Definition of reorganization.*—As used in this section and section 113—

(1) The term "reorganization" means * * * (E) a recapitalization * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * * * * * *

(6) *Tax-free exchanges generally.*—If the property was acquired after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive the basis * * * shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law

applicable to the year in which the exchange was made. * * *

* * * * * * * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(b) *Source of Distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

* * * * * * * * *

(d) *Other Distributions from Capital.*—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, * * *.

* * * * * * * * *

(f) *Stock Dividends.*—

(1) *General Rule.*—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(2) *Election of Shareholders as to Medium of Payment.*—Whenever a distribution by a corporation is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either (A) in its stock or in rights to acquire its stock, of a class which if distributed without election would be exempt from tax under paragraph (1), or (B) in money or any other property (including its stock or in rights to acquire its stock, of a class which if distributed without election would not be exempt from tax under paragraph (1)), then the distribution shall constitute a taxable dividend in the hands of all shareholders, regardless of the medium in which paid.

. . . . . .

(h) *Effect on earnings and profits of distributions of stock.*—The distribution (whether before January 1, 1939, or on or after such date), to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property or money, shall not be considered a distribution of earnings or profits of any corporation—

(1) if no gain to such distributee from the receipt of such stock or securities, property or money, was recognized by law, or

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115 (f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

As used in this subsection the term "stock or securities" includes rights to acquire stock or securities.

. . . . . .

(j) *Valuation of Dividend.*—If the whole or any part of a dividend is paid to a shareholder in any medium

other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.

Treasury Regulations 94, relating to the Revenue Act of 1936:

Art. 115-7. [The material provisions of this Article, as originally promulgated and in force prior to amendment in January 1942 by T. D. 5110, *infra*, were the same as the material provisions of Sec. 19.115-7 of Regulations 103, *infra*, prior to its amendment in November, 1940 by T. D. 5020, *infra*.]

Treasury Regulations 101, relating to the Revenue Act of 1938:

Art. 115-7. [The material provisions of this Article, as originally promulgated and in force prior to amendment in January 1942 by T. D. 5110, *infra*, were the same as the material provisions of Sec. 19.115-7 of Regulations 103, *infra*, prior to its amendment in November 1940 by T. D. 5020, *infra*.]

Treasury Regulations 103, relating to the Internal Revenue Code:

Sec. 19.115-7. *Stock dividends.*—[As in effect during the year 1939 and until amended in November 1940 by T. D. 5020, *infra*.]

A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution. The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute in-

come within the meaning of the Constitution.[1] The distinction between a stock dividend which does not, and one which does, constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution is the distinction between a stock dividend which works no change in the corporate entity, the same interest in the same corporation being represented after the distribution by more shares of precisely the same character, and a stock dividend where there either has been a change of corporate identity or a change in the nature of the shares issued as dividends whereby the proportional interest of the shareholder after the distribution is essentially different from his former interest. A stock dividend constitutes income if it gives the shareholder an interest different from that which his former stock holdings represented. A stock dividend does not constitute income if the new shares confer no different rights or interests than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old.

. . . . . .

Example (2): On July 1, 1938, the Y Corporation had an authorized capital stock consisting of 1,000 shares of common stock, par value $100 a share, of which 500 shares were outstanding. It had earnings and profits of $40,000 accumulated since February 28, 1913, and $5,000 of earnings and profits of the taxable year. On July 1, 1938, the Y Corporation issued and divided among its shareholders 250 additional shares

[1] See *Eisner* v. *Macomber* (252 U. S. 189, T. D. 3010, C. B. 3, 25 (1920)); and *Koshland* v. *Helvering* (298 U. S. 441, Ct. D. 1124, C. B. XV-1, 219 (1936)). Compare *United States* v. *Phellis* (257 U. S. 156, T. D. 3270, C. B. 5, 37 (1921)); *Rockefeller* v. *United States* (257 U. S. 176, T. D. 3271, C. B. 5, 34 (1921)); *Cullinan* v. *Walker* (262 U. S. 134 T. D. 3508, C. B. II-2, 55 (1923)); *Weiss* v. *Stearn* (265 U. S. 242, T. D. 3609, C. B. III-2, 51 (1924)); and *Marr* v. *United States* (268 U. S. 536, T. D. 3755, C. B. IV-2, 116 (1925)).

of its common stock of a total par value of $25,000 and transferred an equivalent amount from surplus account to capital stock account. The stock so distributed does not constitute a taxable stock dividend to the shareholders.

. . . . . .

T. D. 5020, 1940—2 Cum. Bull. 118:

To Collectors of Internal Revenue and Others Concerned:

Section 19.115-7 of Regulations 103 [Part 19, Title 26, Code of Federal Regulations, 1940 Sup.] is amended by striking out all the matter appearing after the first sentence thereof.

(This Treasury decision is issued under the authority contained in section 62 of the Internal Revenue Code (53 Stat., 32).)

TIMOTHY C. MOONEY,
Acting Commissioner of Internal Revenue.

Approved November 15, 1940.
John L. Sullivan,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register November 19, 1940, 3.27 p. m.)

T. D. 5110, 1942—4 Int. Rev. Bull. 7:

To Collectors of Internal Revenue and Others Concerned:

Article 115-7 of Regulations 94 [section 3.115-7, Title 26, Code of Federal Regulations] and article 115-7 of Regulations 101 [section 19.115-7, Title 26, Code of Federal Regulations, 1939 Sup.] are each amended by strik-

ing out all of the matter appearing after the first sentence thereof.

(This Treasury decision is issued under the authority contained in section 62 of the Revenue Act of 1936 (49 Stat., 1673, 26 U. S. C. Sup. 62) and section 62 of the Revenue Act of 1938 (52 Stat., 480, 26 U. S. C. Sup. 62).)

Guy T. Helvering,
Commissioner of Internal Revenue.

Approved January 19, 1942.

John L. Sullivan,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 20, 1942, 3.58 p. m.)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

SYLVIE R. GRIFFITHS,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

RESPONDENT'S SUPPLEMENTAL MEMORANDUM.

ROLAND L. REDMOND,
ALLIN H. PIERCE,
Counsel for the Respondent,
No. 2 Wall Street,
New York, N. Y.

THE COURT PRESS, N. Y. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, Commissioner of Internal Revenue,

Petitioner,

v.

SYLVIE R. GRIFFITHS,

Respondent.

RESPONDENT'S SUPPLEMENTAL MEMORANDUM.

Pursuant to permission granted during the argument of this case on December 7, 1942, this memorandum is submitted for the sole purpose of drawing the Court's attention to the apparent inaccuracy of the statement on page 31 of the petitioner's brief, reading as follows:

> "Thus the Treasury estimates that, during the calendar year 1936, over 4½ billion dollars of corporate income will be withheld from stockholders. If this undistributed income were distributed, it would be added to the income of stockholders and there taxed as is other personal income. But, as matters now stand, it will be withheld from stockholders by those in control of these corporations. In one year alone, the Government will be deprived of revenues amounting to over $1,300,000,000."

The Treasury Department has for a number of years published its so-called "Statistics of Income" and these show in detail the receipts and disbursements of all corporations subject to Federal income, excess profits or other taxes. The item called "Compiled net profit less total tax" is the difference between total receipts (including partially and wholly tax exempt receipts) and the aggregate of all statutory deductions and the Federal income tax and, in the years where applicable, excess profits tax and surtax on undistributed profits. "Compiled net profit less total tax" therefore includes the gross sum available for distribution to stockholders.

These statistics also show separately the dividends distributed by the reporting corporations in cash and in stock. For the years 1937 and 1938 the so-called "Cash dividends" have included dividends paid in cash or in assets other than the corporation's own stock; and "Stock dividends" have included all distributions "in the corporation's own stock". This precise language is not used in the statistics for prior years, the dividends being usually expressed in the following terms, "Cash dividends paid" and "Stock dividends paid".

We set forth below the figures for the years 1929 to 1933 inclusive, showing "Compiled net profit less total tax", and the dividends distributed in cash and in stock. In accordance with the practice of the Treasury Department, all statistics are expressed in term of $1000.

	"Compiled net profit less total tax."	"Cash dividends."	"Stock dividends."
1929	$10,676,071	$8,355,661	$1,288,642
1930	3,947,005	8,262,241	414,180
1931	D. 1,175,596	6,151,083	163,530
1932	D. 4,115,377	3,885,601	143,076
1933	D. 1,353,141	3,127,459	102,043

	"Compiled net profit less total tax."	"Cash dividends."	"Stock dividends."
1934	2,379,169	4,889,379	214,763
1935	4,687,959	5,940,620	135,851
1936	6,579,509	7,379,333	344,972
1937	6,554,121	7,514,017	188,670
1938	3,271,420	5,013,433	84,580

D. means deficit.

The source of these statistics for each year is as follows:

1929 "Statistics of Income for 1929," U. S. Treasury Dept., Table 14, Part 1, p. 268.

1930 "Statistics of Income for 1930," U. S. Treasury Dept., Table 14, Part 1, p. 214.

1931 "Statistics of Income for 1931," U. S. Treasury Dept., Table 13, Part 1, p. 130.

1932 "Statistics of Income for 1932," U. S. Treasury Dept., Table 13, Part 1, p. 136.

1933 "Statistics of Income for 1933," U. S. Treasury Dept., Table 13, Part I, p. 142.

1934 "Statistics of Income for 1934, Part 2," U. S. Treasury Dept., Table 2, Part I, p. 48.

1935 "Statistics of Income for 1935, Part 2," U. S. Treasury Dept., Table 3, Part I, p. 40.

1936 "Statistics of Income for 1936, Part 2," U. S. Treasury Dept., Table 3, Part I, p. 70.

1937 "Statistics of Income for 1937, Part 2," U. S. Treasury Dept., Table 3, Part I, p. 58.

1938 "Statistics of Income for 1938, Part 2," U. S. Treasury Dept., Table 3, Part I, p. 76.

Only preliminary reports have been published in respect of the "Statistics of Income for 1939" and subsequent years.

These statistics support entirely the statement made by counsel for the respondent, in the course of oral argument, that the dividends distributed by American corporations, particularly in the depression period, far exceeded their total income. If, in the above years, corporations had been taxed in the same manner as partnerships, as suggested by the petitioner, instead of an increase in income tax payable by individuals, there would have been a vast loss.

Respectfully submitted,

ROLAND L. REDMOND,
ALLIN H. PIERCE,
Counsel for the Respondent.
No. 2 Wall Street,
New York, N. Y.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 467.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
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BRIEF AMICUS CURIAE.

JOHN E. HUGHES,
Amicus Curiae.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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IN THE

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
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BRIEF AMICUS CURIAE.

May it Please the Court:

It is respectfully submitted that this case can and should be decided merely by construction of the following statute (page 40 government brief in Strassburger case):

> "Sec. 115 (f) Stock Dividends.—(1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

If All Stock Dividends Are Subject to Tax the Statute is Superfluous.

The statute bluntly declares certain stock dividends "*shall not be treated as a dividend.*"

If all stock dividends are taxable dividends, the quoted phrase means absolutely nothing. If a dividend like that at bar is non-taxable it has meaning. It is a cardinal rule of statutory construction that a statute will not be construed to be superfluous where it can be given effect. "There is a presumption against a construction which would render a statute ineffective." *Bird* v. *United States*, 187 U. S. 118, 124.

If Congress, when it enacted this statute, had considered all stock dividends were subject to tax it surely would not have phrased the statute in that way. If it had intended to say all stock dividends were subject to tax it knew how to say so, as it did in the Statute involved in *Eisner* v. *Macomber*. No intelligence is required to say so in simple language.

All members of Congress were familiar with the Macomber case and knew that under it a stock dividend such as the one in the case at bar was not taxable. When they enacted a law declaring a stock dividend "*shall not be treated as a dividend* to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution," their intention can only be ascertained and given effect by taking judicial notice of what is a matter of common knowledge viz: that at the time the legislators enacted the statute to be here construed the overwhelming majority of them knew and believed, as this court had held, that dividend such as that in the case at bar was not taxable income under the Sixteenth Amendment. Such was then the supreme law of the land and all members of Congress are conclusively presumed to have known it and to have had it in mind.

The suggestion has been advanced by the government that by this statute the majority of Congress wanted to

overrule the Macomber case but out of courtesy to the court did not say so (a courtesy without historical precedent).

This suggestion involves a condition of fact and if there were any basis for it the fact could certainly be quite clearly shown. It would not be in the realm of nebulous conjecture. It is conclusively refuted by the existing *fact* that not a syllable in the legislative history of the statute can be cited to support it. It is further completely demolished by the blunt and unambigous statement of the member in charge of the bill in the House that it was not intended by this section to strike at the Macomber decision. That is all there is to the case at bar.

Six rules, among others, make for the taxpayer's construction of section 115(f). They are: (1) "If doubt exists as to the construction of a taxing statute the doubt should be resolved in favor of the taxpayer." *Hassett* v. *Welch*, 303 U. S. at p. 314. (2) If the construction of a statute contended for will raise a serious constitutional doubt and another construction can reasonably be adopted which will avoid it, the court will adopt it (cases quoted from below). (3) The contemporaneous administrative construction of a statute will be given great weight. Here it supports taxpayer. (4) Especially is this so where those affected have acted in reliance thereon. (5) When Congress reenacts a statute, after the promulgation of an administrative regulation construing it such construction is thereby approved by Congress (cases cited below for (3) (4) and (5). (6) Just as the courts have held tax laws imposing retroactive liabilities unconstitutional (*Untermyer* v. *Anderson*, 276 U. S. 440) because contrary to due process so they are loath to overrule one of their own decisions when its overruling will impose an unexpected retroactive liability. There is no difference between the imposition of such liability by the Judicial than by the legislative branch of government (compare Cardozo the "Nature of Judicial Process.")

It is undeniable that, in view of the Macomber decision, the construction for which the government contends would at least raise a serious constitutional doubt.

When Congress enacted this section it must be taken to have been thoroughly familiar with the following firmly established rule of the law, thus stated by Mr. Justice Brandeis in *Wright* v. *Vinton Branch*, 300 U. S. 440 at p. 461:

> "If we were in doubt as to the intention of Congress we should still be led to that construction by the well settled rule: 'When the validity of an act of Congress is drawn in question, and even if a serious doubt of constitutionality is raised, it is a cardinal principal that this court will first ascertain whether a construction of the statute is fairly possible by which the question may be avoided.'"

In *United States* v. *La France*, 282 U. S. 568, it is said at page 574:

> "The decisions of this court are uniform to the effect that 'a statute must be construed if fairly possible, so as to avoid not only the conclusion that it is unconstitutional but also grave doubts on that score".

In *Lucas* v. *Alexander*, Collector 279 U. S. 573 at p. 577 it is said (opinion by Justice Stone):

> "In answering it the provisions of the taxing statute must be construed with an eye to possible constitutional limitations so as to avoid doubts as to its validity" (citing cases).

See also *Reinicke* v. *Northern Trust Co.*, 278 U. S. 339, 348, 339.

In *Driscoll* v. *Edison Light & Power Co.*, 307 U. S. 104, 115 (opinion by Justice Reed) it was pointed out that where the construction which avoids the constitutional doubt has been adopted by the administrative authorities this court will be inclined to also adopt it.

In the case at bar that is the situation. The Treasury regulations until 1940 expressly declared the construction upon which taxpayer relied and for which taxpayer now contends. No regulation declares the contrary.

When Congress enacted the 1938 Act it is presumed to have known the treasury regulation declaring section 115(f) did not tax a stock dividend such as the one at bar

and it thereby acquiesced in this construction of section 115(f). *Morgan* v. *Commissioner*, 309 U. S. 78 at page 81.

The Treasury up to now has not promulgated any regulation declaring a dividend such as the one in the case at bar is taxable.

If Congress by section 115(f) had intended to tax such a dividend as that in the case at bar the Treasury (its counsel assist Congress in drafting tax legislation) would surely have known it and would have so declared in its regulations. Instead it declared the exact contrary. Most members of Congress thought section 115(f) meant what the Treasury thought it meant.

In *Sanford's Estate* v. *Commissioner*, 308 U. S. 39, the court said at page 52 and administrative construction might be of persuasive weight and: "This is more so when reliance has been placed on the practice by those affected by it." This is also true of contemporaneous administrative regulations. *United States* v. *American Trucking Association*, 310 U. S. at page 549.

The Legislative History Indicates Congress Would Not Have Taxed a Dividend of Common on Common Stock Assuming It Thought it Could Do So.

This Court has said:

> "Taxation is eminently practical" and that it is "concerned with substance."

Why would Congress in the same law expressly declare an exchange of common stock for common stock in the same corporation not subject to tax and declare a dividend of common on common stock taxable? One cannot advance any reason without imputing want of sound judgment to the legislators. A stockholder can exchange one share of common for two shares of common stock and be in the same position a 100 per cent stock dividend of common on common leaves him. Congress must surely be taken to have known this. (This exchange section of the statute does not require a reorganization.)

The flood of stock dividends which followed the Macomber decision were traded and exchanged and brought the treasury millions in revenue from stock transfer taxes and from profits on sales. Also income tax was paid by the brokers on the commissions they received selling the stock and corporations made profit on the capital retained and paid income tax on such profit. All this Congress knew.

If stock dividends are taxable, there will not be many more because tax rates (52 per cent on the first dollar above $18,000. and shooting steeply up) are too high.

For estate tax an estate is allowed by statute to value stock at what it sells it for within one year after death. Executors can get more for the stock of closely held corporations, with not many outstanding shares, if they can dilute and make a public offering of the shares because the market for it will be greater. If they get more, the revenue gets more estate tax. The overruling of the Macomber case will dry up these sources of future revenue.

Also, if you bought last month a share of stock in a corporation with $200. a share surplus and $100. a share capital and it declared a 100 per cent stock dividend the day after you bought the stock what will you be taxed on? You are not a cent richer than immediately before you bought your stock. In the case at bar the deficiency is based on the fair market value of the stock dividend but in some cases the fair market value will be partly due to original capital and not profits.

The overruling of *Eisner* v. *Macomber* would entitle corporations such as the Standard Oil Company declaring stock dividends to refunds from 1936 to 1939, because taxable dividends were a credit against the 27 per cent undistributed profits tax. Also if a stockholder received a stock dividend in an earlier year and sold it in 1940 or 1941 he could get a refund after allowing the government credit for the tax he should have paid when he received it, because each year rates have been increased. Also a corporation charged with accumulating earnings to avoid surtax on its shareholders

could beat the charge by pointing to stock dividends. In other words the case runs through the whole income tax structure and the above are only some of the many matters Congress would have to consider before taxing stock dividends heretofore considered non-taxable. It is submitted they would be sufficient to induce Congress to repeal, from standpoint of the revenue alone, any retroactive effect a decision of this Court might have.

The courts attention is called to the brief filed by this *amicus curiae* in the *Strassburger* case.

The following statement in the government brief in the Strassburger case (p. 8) is eminently sound:

> "The problem is essentially, and by its very nature, legislative in character."

However if the majority of the court think the Macomber case should be overruled without waiting for Congress to unequivocally say so this Amicus Curiae respectfully suggests and submits the Court might say in its opinion that if Congress had unequivocally taxed a stock dividend of common on identical common it would be disposed to uphold the tax because it considers the problem essentially legislative but it cannot say (at least beyond doubt) that Congress has done so by the statute involved in the case at bar. That ought to satisfy the government, (See letter of Treasury Counsel, Appendix A) do no retroactive injustice to taxpayers who relied on this courts opinion and express statements in the treasury regulations and leave the problem to Congress. Through its Committees Congress can hold hearings and thoroughly consider the problem from the standpoint of its broad effect on the revenue.

A disposition of the case as thus suggested will not do harsh and retroactive injustice to thousands who acted in reliance on the decision of this court and on the example in the Treasury regulations stating a dividend exactly like that in the case at bar was not taxable. It will avoid the injustice expressed by this court, in its unanimous opinion in *Schwab* v. *Doyle* thus (258 U. S. at p. 534):

> "Retrospective laws are indeed generally unjust and as has been forcibly said, neither accord with sound legislation nor the fundamental principles of the social compact."

And it will not, in the words of Justice Holmes, impose retroactive liabilities "which if known might have induced those concerned to avoid it and use their money in other ways." *Lewellyn* v. *Frick*, 268 U. S. 236, 252.

It is for this reason that the late Justice Cardozo in "The Nature of Judicial Process", pointed out courts are reluctant to overrule their earlier decisions.

Most people who received stock dividends never saved the money to pay tax on them, because they were told by Treasury regulations they were not taxable.

If the court disposes of the case in this way Congress, after thoroughly considering the problem, may well conclude not to tax a dividend of common on identical common for the same reasons it has concluded to allow common to be exchanged for common tax free and the other reasons above stated and no one can contend the Macomber case fetters the taxing power or advance any reason for overruling it.

All of which is respectfully submitted.

JOHN E. HUGHES,
Amicus Curiae.

APPENDIX A.

GENERAL COUNSEL.

TREASURY DEPARTMENT.

WASHINGTON.

Aug. 12, 1942.

Mr. John E. Hughes,
105 West Adams Street,
Chicago, Illinois.

Dear Mr. Hughes:

I have your letter of August 10, 1942, transmitting a proposed draft of an amendment to section 3791(b) of the Internal Revenue Code dealing with the nonretroactive application of a Supreme Court decision. Although the draft is general in terms you have apparently submitted it in view of the possible over-ruling by the Supreme Court of its decision in *Eisner* v. *Macomber*, 252 U. S. 189, discussed by you in your testimony before the Senate Finance Committee on August 6, 1942.

In my opinion the Treasury Department should favor legislation, retroactive in application, validating with respect to distributions made prior to the date of the overruling decision such a treatment of stock dividends as is consistent with the views of the Supreme Court originally announced in *Eisner* v. *MaComber* and later qualified in *Koshland* v. *Helvering*, 298 U. S. 441; *Helvering* v. *Gowran*, 302 U. S. 238, and *Helvering* v. *Pfeiffer*, 302 U. S. 247. You are, of course, aware that the doctrine of *Eisner* v. *MaComber* has been restricted in its application to a rather limited field since December 31, 1935. The relatively few cases arising in intervening years and currently considered subject to its application, whether pending adjustment or closed at the time of a later pronouncement by the Supreme Court, should not be affected by the ultimate abandonment of the rule. In other words I believe that the Treasury Department should favor an enactment in which Congress

might well provide in effect that the ultimate over-ruling of *Eisner* v. *MaComber* should not affect the character, for Federal tax purposes, of stock dividend distributions made in prior years.

I assure you that your draft of legislation will be given careful consideration.

Very truly yours,

(Signed) RANDOLPH PAUL,
General Counsel.

APPENDIX B.

The quotation from the Wisconsin Court on page 24 of the government brief in the Strassburger case begs the question by assuming a stock dividend is income. It then says the legislature and people in adopting the amendment intended to tax it.

The fact is that most citizens of Wisconsin voting for the amendment didn't know what a stock dividend was (and the average one couldn't tell you today what it is). They never gave the question whether it was taxable a thought. As to the legislatures of the states which adopted the 16th amendment, if they had appointed committees of the most eminent lawyers in the state to advise them whether a stock dividend was income they would have reported that in 1891 this court in *Gibbons* v. *Mahon*, 136 U. S. 549, had held it was not. If Justice Holmes had been one of these lawyers it is not unreasonable to assume he would have reported what he said in *Towne* v. *Eisner*, 245 U. S. 418, which it is suggested the court reread.

SUPREME COURT OF THE UNITED STATES.

No. 467.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Sylvie R. Griffiths. } On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 1, 1943.]

Mr. Justice Jackson delivered the opinion of the Court.

The question in this case is whether the Acts of Congress and the administrative regulations thereunder afford a basis on which we may reconsider the decision in *Eisner* v. *Macomber*, 252 U. S. 189, and pass on the Government's request that it be overruled.

During the calendar year 1939 respondent owned 101 shares of common stock of the Standard Oil Company of New Jersey. Twice during the year that corporation made appropriate transfers from earned surplus to its capital accounts, in amounts less than the net accumulation of earnings and profits subsequent to February 28, 1913, and against them issued stock dividends. On June 15, 1939, respondent received a dividend of 1.01 such shares having a fair market value of $42.93. On December 15, 1939, she received a further dividend of 1.53 shares, which had a fair market value of $66.08. These dividends were in common stock identical with the stock on which they were declared, which was the only stock outstanding at the time they were made. The dividend stock was not sold, redeemed, or in any way realized upon, and the taxpayer did not include it as income in her return for 1939. The Commissioner did so include it, and on December 8, 1941, sent her a notice of deficiency in the amount of $9.60. The Board of Tax Appeals reversed his determination, and the Circuit Court of Appeals for the Second Circuit affirmed on the authority of *Eisner* v. *Macomber*, *supra*: 129 F. 2d 321. Because of the importance of the question we granted certiorari. — U. S. —.

The tax is asserted under the general provision of § 22(a) of the Internal Revenue Code that income includes "dividends," together with the specific provision of § 115(f)(1) that: "A distribution made by a corporation to its shareholders in its stock or in

rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constituion."[1]

Was Congress thereby saying that such a dividend as we have here is not being taxed, in view of the *Eisner* v. *Macomber* decision, or was it saying that regardless of that decision it is being taxed? Events which must be considered to determine which Congress intended begin with the enactment of the Revenue Act of 1913, which taxed corporate "dividends" in general but said nothing of stock dividends in particular.[2] The Treasury attempted to tax them, and this Court held that a dividend of common stock paid on stock of the same kind was not income within the meaning of the Act, intimating, however, that as used in the Sixteenth Amendment "income" might have a wider scope. *Towne* v. *Eisner*, 245 U. S. 418 (1918). Congress had meanwhile provided that a "stock dividend shall be considered income, to the amount of its cash value."[3] Under that Act the Commissioner asserted that a dividend in common stock paid on common stock constituted income when received. This Court held it was not income within the meaning of the Sixteenth Amendment, chiefly for the reason that income had not been severed from capital or realized by such a distribution. *Eisner* v. *Macomber*, 252 U. S. 189 (1920). This decision was by a divided Court, Justices Holmes and Brandeis each writing a dissenting opinion, in which respectively Justices Day and Clarke joined. It was promptly and sharply criticised.[4]

Although *Eisner* v. *Macomber* dealt only with a dividend of common stock to common stockholders, it was at once accepted as

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[1] 53 Stat. 1, 9, 47. § 22(a) provides that "'Gross income' includes gains, profits, and income derived from . . . dividends . . . ."
§ 115(a) provides that "The term 'dividend' . . . means any distribution made by a corporation to its shareholders, whether in money or other property. . . ." 53 Stat. 1, 46.

[2] § II B of this Act, 38 Stat. 114, 167, provided that "net income . . . shall include . . . gains, profits, and income derived from . . . dividends . . ."

[3] § 2(a) of the Revenue Act of 1916, 39 Stat. 756, 757.

[4] Seligman, Implications and Effects of the Stock Dividend Decision, (1921) 21 Columbia Law Review 313; Warren, Taxability of Stock Dividends as Income, (1920) 33 Harvard Law Review 885; cf. Powell, Constitutional Aspects of Federal Income Taxation, in The Federal Income Tax (Columbia University Lectures, 1921) 51; Ballantine, Corporate Personalty in Income Taxation, (1921) 34 Harvard Law Review 573; Powell, Income from Corporate Dividends, (1922) 35 Harvard Law Review 363; Clark, Eisner v. Macomber and Some Income Tax Problems, (1920) 29 Yale Law Journal 735. But cf. Fairchild, The Stock Dividend Decision, (1920) 5 National Tax Association Bulletin 208.

the basis for a broader exemption. The Treasury ruled that receipt of dividend stock generally was not income, and Congress provided in § 201(d) of the Revenue Act of 1921 that "A stock dividend shall not be subject to tax . . ."[5] Treasury Regulations under this statute and subsequent re-enactments construed it as covering all dividends paid in stock of the distributing corporation.[6]

There the matter stood for nearly fifteen years, although in the meantime this Court pointed out in reorganization cases that a distinction existed between the type of stock dividend before it in *Eisner* v. *Macomber* and one which gave the stockholder a different stock, or different proportionate interests, than before. *United States* v. *Phellis*, 257 U. S. 156 (1921); *Rockefeller* v. *United States*, 257 U. S. 176 (1921); *Cullinan* v. *Walker*, 262 U. S. 134 (1923); *Weiss* v. *Stearn*, 265 U. S. 242 (1924); *Marr* v. *U. S.*, 268 U. S. 536 (1925).

Inaction did not mean however that persons who received stock dividends were escaping all support of the revenues. Taxation was only postponed, as is taxation of many securities taken in corporate reorganizations, until sale or other realization has occurred. Their proceeds when realized have always been taxable as income. The Treasury had come to compute the postponed tax under Regulations which as to some classes of stock apportioned the cost basis between the old stock and the dividend stock in accordance with their respective fair market values at the time the stock dividend was issued.[7] On March 30, 1936, this Court granted certiorari in *Koshland* v. *Helvering*, 298 U. S. 441, in which the taxpayer challenged the validity of the apportionment Regulations. 297 U. S. 702. She had owned certain preferred stock and had received a dividend of common shares

[5] T. D. 3052, 3059, 3 Cum. Bull. 38; O. D. 732, 3 Cum. Bull. 39; O. D. 801, 4 Cum. Bull. 24; 42 Stat. 227, 228. The House Report stated that this Act modified "the definition of dividends in existing law by exempting stock dividends from tax, as required by the decision of the Supreme Court in Eisner v. Macomber." H. Rept. No. 350, 67th Cong., 1st Sess., pp. 8-9. The Senate Report was to the same effect. S. Rept. No. 275, 67th Cong., 1st Sess., p. 9.

[6] See Article 1548, Treasury Regulations 62 (promulgated under the Revenue Act of 1921), 65 (promulgated under the Revenue Act of 1924) and 69 (promulgated under the Revenue Act of 1926); Article 628, Treasury Regulations 74 (promulgated under the Revenue Act of 1928) and 77 (promulgated under the Revenue Act of 1932); Article 115-8 of Treasury Regulations 86 (promulgated under the Revenue Act of 1934).

[7] Article 1548, Treasury Regulations 62; Articles 1548, 1599, Treasury Regulations 65 and 69; Articles 600, 628, Treasury Regulations 74.

thereon. The preferred was thereafter redeemed, and the Commissioner applied the allocation rule, which reduced the cost basis of this old stock. This, of course, increased her gain on the redemption of the old stock and added to her tax. She argued that her dividend, notwithstanding *Eisner* v. *Macomber*, to which she gave a narrow reading, was constitutionally taxable as income at the time received. The Court held unanimously and squarely that the dividend in question did constitute income within the Sixteenth Amendment, and in effect limited *Eisner* v. *Macomber* to the kind of dividend there dealt with. But it did not overrule that decision or question its authority as to dividends such as we have in this case. With two Justices dissenting it struck down the apportionment regulations as being beyond statutory authorization.

While the Court was considering stock dividends in the *Koshland* case, Congress was considering them in connection with the pending Revenue Act for 1936.

On March 3, 1936, the President had suggested the enactment of a tax upon the undistributed income of corporations.[8] On March 26, 1936, and while the taxpayer's petition for certiorari in the *Koshland* case was pending, a Subcommittee of the House Ways and Means Committee recommended that such a tax be enacted in lieu of the existing capital-stock, excess-profits, and income taxes on corporations.[9] It was thought by some authorities that imposition directly upon shareholders of a tax based on their pro rata shares of corporate earnings would be more satisfactory than the undistributed-profits tax.[10] Serious consideration of this method, which

[8] H. Doc. No. 418, 74th Cong., 2d Sess., pp. 2-3.

[9] H. Rep. Committee Print, March 26, 1936, 74th Cong., 2d Sess., Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 5-8.

[10] See statement of Congressman Vinson, 83 Cong. Rec. 2780: "After the decision of the Supreme Court in 1920, it was no longer possible for us to impose a tax upon the shareholder with respect to the undivided profits of a domestic corporation. We were forced to adopt the system of levying a special penalty tax on the corporation itself, which has been exceedingly difficult to enforce in the courts and is nothing like as effective as if we could ignore the corporation and tax the shareholders direct upon his undistributed earnings in the profits of the corporation."

See also, Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 193, 505-606; cf. Hearings on the Revenue Act, 1936, Senate Finance Committee, 74th Cong., 2d Sess., pp. 210-211, 256-257; H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 2-3; Report of the Subcommittee of the Committee on Ways and Means Relative to Proposed Tax Revisions 1938, pp. 2-3. For earlier proposals, see statement of Oliphant, General Counsel of the Treasury, Hearings on the Revenue Act, 1936, House Ways of the Revenue Laws, 75 Cong., 3 Sess., January 14,

had been employed in earlier times,[11] was foreclosed by the belief that *Eisner* v. *Macomber* made it "impossible" to put into effect.[12]

The statements of members of Congress and of responsible Treasury officials at the hearings and debates on the Act are at variance with the present assertion of the Government that Congress intended § 115(f)(1) to challenge or override the decision to which it had in other sections of the Act accommodated itself.

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and Means Committee, 74th Cong., 2d Sess., p. 658; *id.* at 820; Martin, Taxation of Undistributed Corporate Profits, (1936) 35 Michigan Law Review 44, 45, *et seq.*

[11] The Revenue Act of 1864, 13 Stat. 218, 282, provided that "gains and profits of all companies, whether incorporated or partnership . . . shall be included in estimating the annual gains, profits, or income of any person entitled to the same, whether divided or otherwise." Compare Collector v. Hubbard, 12 Wall. 1, 17, with Pollock v. Farmers' Loan & Trust Co., 158 U. S. 601, and Eisner v. Macomber, 252 U. S. 189, 218, 230-232. See also, 13 Stat. 480; 14 Stat. 5, 478; 16 Stat. 258.

[12] Congressman Hill objected to a proposal that stockholders be taxed like partners, on the ground that Eisner v. Macomber stood in the way. House Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 96, 97, 98. Congressman Lewis stated: "I do not know that it is fully understood by the public that this roundabout device of compelling the distribution of the real income of the corporation to its shareholders, so that the shareholders may be called upon to pay taxes upon their income, is due to a decision of a divided court. Some years ago the Supreme Court in a sharp decision determined that we could not do in the United States with regard to earned dividends that were not distributed what they do in other countries, especially in England, require the shareholder to pay his tax on his income just the same whether his company had refused to distribute it or not.

"Now, if that decision of the Court should be reversed, what we are doing here, or attempting to do in order to reach the taxpayer here, the method of our attempt, would not be necessary. Not ours the fault of all this clumsiness and indirection of approach to a necessary public object." *Id.* at 193.

Later he said: "Of course, we cannot reach the net earnings of the corporation as earnings of the individual stockholders until the earnings are distributed as dividends." *Id.* at 321. See also, *id.* at 745, 83 Cong. Rec. 3125.

In the Senate debates, Senator Black stated in response to a question whether it was "legally possible to say to each corporation, 'Make a report of the proportionate earnings of each stockholder,' as we would to a partnership, and then let the stockholder make his return?" that "Unfortunately that was done about 60 years ago, and while it is my recollection that the Supreme Court itself sustained the act, it later, by another divided opinion, changed its mind and struck down the act as being in contravention of the Constitution. So that it is impossible to tax the undistributed profits which remain in the corporate treasury as a part of the individual incomes of the stockholders." 80 Cong. Rec. 8813.

Compare colloquy between Congressman Lewis and Alvord, *infra*, note 37; Helvering v. National Grocery Co., 304 U. S. 282; Heiner v. Mellon, 304 U. S. 271; Helvering v. Gerhardt, 304 U. S. 405, 425. But see Powell, The Stock-Dividend Decision and the Corporate Nonentity, (1920) 5 National Tax Association Bulletin 201; Clark, *supra*, note 4, at 742; Traynor, Tax Decisions of the Supreme Court, 1937 Term, (1938) 33 Illinois Law Review 371, 388.

At the hearings of the Congressional Committees the proposed tax was attacked as being a measure which would have the effect of forcing the distribution by corporations of assets needed in their business. Its supporters anticipated the decision of this Court in the *Koshland* case and countered with statements that dividends taxable as income to the shareholders—which would have the effect of avoiding the undistributed-profits tax on the corporation[13]—could be declared and the undistributed-profits tax avoided without the necessity of distributing assets.[14] No testimony was given, however, that dividends such as we have in this case were legally taxable or intended to be taxed.[15]

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[13] § 27(f) of H. R. 12395, 74th Cong., 2d Sess., which became § 27(e) of the Revenue Act of 1936, 49 Stat. 1648, 1665.

[14] In questioning Kent, Acting Chief Counsel of the Bureau of Internal Revenue, at the House hearings, Congressman Vinson of Kentucky said: "in reference to the retention of the cash in the business by the use of taxable stock dividends, I would like you to develop that, because I think it is very interesting. I think that it will allay a major portion of the fear that some folks have that in this favored treatment of corporations declaring large percentages of dividends the capital structure of a corporation would be in danger, or that thereby it would not have the money for the rainy day." Kent replied: "There have been several decisions recently—I may say that one of them has now reached the Supreme Court of the United States—that have taken the position that the constitutional immunity of the true stock dividend recognized or declared in *Eisner* v. *Macomber* does not apply to all types and varieties of so-called stock dividends; for instance, that if the directors of a corporation instead of paying a large cash dividend to the preferred shareholders of the corporation see fit to give them common stock instead, that dividend of common stock is taxable so far as the constitution is concerned.

"I may say that in a case which is pending before the Supreme Court there is a question also of the statutory interpretation, but assuming, as I believe is a proper legal view of the case, that so far as the Constitution is concerned, there are types of stock dividends that may be taxed under the Constitution, that it would provide a loophole. Then, also, of course there is the so-called optional stock dividend in which the stockholder is given the option of taking cash or taking stock. For any shareholder who wishes to maintain his proportionate equity in the enterprise there is a very powerful incentive to take stock." Congressman Vinson said: "Such option is property that has a value and, in your opinion, takes that entirely out of the stock dividend which was involved in the case of *Eisner* v. *Macomber;* is that right?" Mr. Kent: "That is correct." House Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 592-593.

See also, similar statements at the Senate hearings by Haas, Director of Research and Statistics for the Treasury Department, and Oliphant, General Counsel of the Treasury. Senate Hearings on the Revenue Act, 1936, Senate Finance Committee, 74th Cong., 2d Sess., pp. 38, 909, 917-918.

[15] The Government calls attention to a memorandum submitted to the Senate Finance Committee by Graham, Lecturer in Finance at Columbia University, which stated that: "The most suitable method of capitalizing reinvested earnings and making them taxable to the stockholders, would be through the declaration of taxable dividends in common stock. While the decision in *Eisner* v. *Macomber* stands in the way of this ideal arrangement, I believe that in view of the different philosophy of taxation embodied in the pending

As reported by the House Ways and Means Committee and passed in the House, § 115(f)(1) of the Bill provided: "A distribution made by a corporation to its shareholders in stock of the corporation or in rights to acquire stock of the corporation shall be treated as a taxable dividend to the extent that such distribution constitutes income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution and represents a distribution of earnings or profits accumulated after February 28, 1913."[16] The Committee Report stated that: "It is provided in Sec. 115(f) that stock dividends shall be subject to tax to the extent that such dividends constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution."[17]

The manager of the Bill, Congressman Vinson of Kentucky, stated on the floor of the House, with reference to Sec. 115(f)(1): "In no sense is this an attack upon the Eisner against Macomber decision. There are many dividends received in stock and stock rights that are distinguishable from the character of stock dividends in the Macomber case, supra, and are actual realized taxable income. As we see it, a stock dividend that is not taxable is one in which the relative interest of each shareholder of a corporation is unchanged in his stock ownership."[18] He submitted a legal memorandum furnished by Arthur Kent, Acting General Counsel of the Bureau of Internal Revenue, setting forth cases dealing with the taxability of stock dividends, sixteen of which, including Eisner v. Macomber, had held stock dividends nontaxable, and twelve of which had held that the dividends were not true stock dividends and thus were taxable. This memorandum was in support of Kent's statement in response to Congressman Vinson's questioning at the hearings before the House Ways and Means Committee, to the effect that "the constitutional immunity of the true stock dividend

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bill, this decision might be overcome by treating such stock dividends as an administrative vehicle for allocating earnings to the various taxpayers." Hearings on the Revenue Act, 1936, Senate Finance Committee, p. 696. Graham did not testify at the hearings, and it is not clear from this statement that he had reference to a dividend of common stock on common stock. Compare his later statement in The Undistributed Profits Tax and the Investor, (1936) 46 Yale Law Journal 1, 6, note 17: "Payments on common in additional common are, of course, non-taxable." Compare Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 93 *et seq.*

[16] H. R. 12395, 74th Cong., 2d Sess.

[17] H. Rep. No. 2475, 74th Cong., 2d Sess., p. 10.

[18] 80 Cong. Rec. 6214-6215.

recognized or declared in *Eisner* v. *Macomber* does not apply to all types and varieties of so-called stock dividends."[19] Congressman Vinson called particular and favorable attention to an article approving the decision in *Eisner* v. *Macomber*, published in the same month by Professor Magill, who had served as Special Assistant to the Secretary of the Treasury in tax matters and has also served as Undersecretary of the Treasury.[20] Congressman Vinson reiterated his views on the following day in response to questions by Congressman Treadway, leader of the opposition to the Bill.[21]

The opinion of this Court in the *Koshland* case was announced on May 18, 1936, six days after the Senate Finance Committee concluded its hearings. This Committee reported out § 115(f)(1) in the form in which it is found in the Act: "A distribution made by

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[19] See note 14, *supra*.

[20] Magill, Realization of Income through Corporate Distributions, (1936) 36 Columbia Law Review 519.

[21] Mr. Vinson. The case of Eisner against Macomber, as I recall, involved a corporation with $1,000,000 common stock. There was a declaration of a $500,000 stock dividend to the common-share holders. The Court held, and I think correctly, that where each shareholder got his proportionate part of the new stock there was no change in his ownership in the corporation. That, in a corporation with a million-dollar capital, the distribution of another half million to the holders of the common stock made no change in ownership. The shareholder who owned a share of stock would own one and a half shares in the increased structure, and therefore there was no change in the ownership so far as he and the corporation were concerned.

It has been evidenced throughout the years that there are innumerable stock dividends that are taxable. The issuance of stock, either common or preferred, or bonds, in payment of dividends may change the proportion of ownership among the shareholders. For instance, let us take this illustration: You issue preferred stockholders common stock to satisfy dividends declared to preferred stockholders. You have introduced additional common stock. It is in the hands of persons other than the present common-stock holders; consequently there is a change in the proportion of ownership in the common-stock holders.

The Supreme Court in one case laid down the rule that the yardstick in respect of the taxability of stock dividends was the character or kind of stock and the change in proportion of ownership. I submitted in the Record yesterday a statement prepared for me by Mr. Kent, Acting General Counsel of the Bureau of Internal Revenue, setting forth decisions of the Supreme Court where stock dividends were held to be nontaxable; and other cases where the Supreme Court and the Board of Tax Appeals held that stock dividends were taxable. In this connection I pointed out that in the April volume of the Columbia University Law Review a gentleman, in whom we have great faith and confidence, the Honorable Roswell Magill, wrote a very comprehensive and illuminating article on the taxability of stock dividends.

Mr. Treadway. . . .

As I recall it, in the present law there was just one line, 115, which read "stock dividends shall not be subject to tax." That is correct?

Mr. Vinson. That is right.

Mr. Treadway. It has been stricken out in this bill, and you are substi-

a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the sixteenth amendment to the Constitution." It stated in explanation of the change: "This subsection of the House bill, under which stock dividends are made taxable to the full extent permitted by the Constitution, is retained by your committee, except for changes made necessary by virtue of the reported amendment of section 115(a) and in the interest of greater clarity."[22]

Senators Black and La Follette of the Senate Finance Committee submitted a minority report recommending an increase in the undistributed-profits tax rates, and also that § 115(f)(1) specifically adopt the formula of the recently decided *Koshland* case, for no apparent reason other than a belief that in its present form it did not clearly have the effect of taxing even the type of stock dividends which the Court held in that case could be taxed.

To this end they recommended that § 115(f)(1) "Specifically provide that there shall be no undistributed-profits tax on stock dividends which are taxable income for the individual recipient because the stock 'gives the stockholder an interest different from that which his former stockholdings represented.'"[23] In

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tuting therefor section (*f*), on page 107, of which the gentleman has given a history.

. . . . . .

Mr. Vinson. The section to which I refer states that the only stock dividends we seek to tax are those which are taxable income within the sixteenth amendment.

Mr. Treadway. The language stricken out, I may say, reads as follows: "(b) Stock dividends: A stock dividend shall not be subject to tax."

That is the existing law and has been the law most of the time since the Eisner against Macomber decision. In the next tax bill after that decision that language was included.

I understand the gentleman's explanation to be that the language of the act was too broad. I do not mean too broad in the sense it is not legal, but it goes further than the Eisner against Macomber decision.

Mr. Vinson. That is correct.

Mr. Treadway. The language now substituted for the stricken language describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed. Is that the right conception of the intention?

Mr. Vinson. Well, we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation, and if they are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes. 69 Cong. Rec. 6309-6310.

[22] S. Rept. No. 2156, 74th Cong., 2d Sess., pp. 18-19.

[23] S. Rept. No. 2156, 74th Cong., 2d Sess., Pt. 2, p. 5, reprinted together with the decision in the Koshland case, 80 Cong. Rec. 8526-8529. Their Re-

opinion of this Court et al

debate on the floor of the Senate, Senator Black said that: "As all Senators know, until about 2 weeks ago it was generally believed that it was impossible to tax stock dividends as income of the recipient of those stock dividends. About 2 weeks ago, however, the Supreme Court of the United States rendered an opinion which appeared in the Record, in which it decided if those stock dividends were declared in a different type of stock than the stock which was originally held by the owner, that those dividends did constitute actual income—taxable income, if you please—in the hands of the stockholder recipient.

"That being true, we have provided in such manner as to avoid any possible misunderstanding, that stock dividends declared in such manner that they are taxable in the hands of the recipient will be considered as distributed profits against which no undistributed-profits tax is imposed."[24]

Senator Bone asked: "Would it not be possible for corporations to evade the effect of that kind of decision of the Supreme Court by distributing stock of a character that would escape taxation?" Senator Black answered that they could, but that they would then be subject to the undistributed-profits tax.[25]

In response to a question by Senator Adams whether it would not be possible to tax stockholders in corporations upon undistributed corporate earnings, as partnerships were taxed upon undistributed partnership earnings, Senator Black stated that this was "impossible,"[26] but that "in order to achieve the same result we have suggested a proposal which imposes no corporate tax on undistributed profits if the corporation declares a stock dividend of such nature as to be taxable under the recent Supreme Court opinion. In that case, the case of Koshland against Helvering, the Court distinguished clearly and unequivocally between a normal stock dividend of the same kind and nature as the stock on which the dividend was declared and a stock dividend of a distinctly dif-

port stated that: "Under the opinion of the Supreme Court in *Koshland* v. *Helvering*, decided May 18, 1936, the Supreme Court decided that stock dividends represented taxable income where they give 'the stockholder an interest different from that which his former stockholdings represented.' It is, therefore, beyond any question of doubt, that under our proposal, corporations would be able to retain all money profits needed for carrying on their business without any additional corporate tax."

[24] 80 Cong. Rec. 8811.

[25] *Ibid.*

[26] See footnote 12, *supra.*

ferent nature from the stock on which the dividend was declared. In order to carry out and obtain the full benefit of that, so that we can permit every corporation, if it desires, to retain 100 cents of every dollar in its treasury, if its stockholders wish, we have provided that there shall not be one dollar of corporate undistributed profit tax imposed upon that corporation if it distributes its dividends in a stock dividend which is taxable in the hands of the stockholders."[27]

Senator La Follette said on the floor of the Senate that "under all these measures—under the House bill, under the Senate committee bill, and under this amendment—any corporation desiring to retain 100 percent of its statutory net income free from increased tax may do so by paying out to its stockholders a dividend which is taxable under the sixteenth amendment."[28]

Senator Robinson stated his approval of the proffered amendment, but suggested that it be withdrawn and the matter taken up in conference. The amendment was accordingly withdrawn, but was not acted upon by the conference.[29]

The meaning of § 115(f)(1) was critical in the administration both of the undistributed-profits tax upon corporations and of the income tax upon shareholders. This was not its only importance, however. Like the earlier Revenue Acts, the Revenue Act of 1936 contained provisions intended to cope with the problem of evasion of income taxes by shareholders through failure to distribute corporate income.[30] These provisions had been drafted to avoid the

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[27] 80 Cong. Rec. 8813.

[28] 80 Cong. Rec. 9048. See also, *id.* at 9045, 9047.

[29] 80 Cong. Rec. 9052.

[30] § 102, 49 Stat. 1648, 1676, laid a graduated additional tax upon the income of corporations other than personal holding companies as defined in § 351, formed or availed of for the purpose of preventing the imposition of the surtax upon their shareholders or the shareholders of any other corporation, through the medium of permitting earnings or profits to accumulate instead of being divided or distributed.

§ 351, 49 Stat. 1648, 1732, laid a graduated surtax upon income of personal holding companies.

Under the Revenue Acts of 1913, 1916 and 1918, if a corporation was availed of for the purpose of evading taxation by accumulation of gains and profits the shareholders were taxed on their pro rata shares of income, whether or not distributed. 38 Stat. 166; 39 Stat. 758; 40 Stat. 1072.

§ 220 of the Revenue Act of 1921 employed instead a tax against the corporation. 42 Stat. 227, 247. H. R. Rep. No. 350, 67th Cong., 1st Sess., pp. 12-13, stated in explanation of the change that: "Section 220 of the existing law provides that if any corporation is formed or availed of for the purpose of evading the surtax upon its stockholders through the medium of permitting its gains and profits to accumulate instead of being divided, the stockholders

limitations set upon Congressional power by *Eisner* v. *Macomber*. It was generally believed that they had failed, and would fail, fully to accomplish their purpose, and that fully effective provisions would entail a challenge of the authority of *Eisner* v. *Macomber*.[31]

In this state of affairs the Treasury issued Regulations which plainly construed § 115(f)(1) not as repudiating *Eisner* v. *Macomber* by taxing stock dividends but as exempting them and adopting the existing decisions, including *Eisner* v. *Macomber*. Article 115-7 of Regulations 94, issued under the Revenue Act of 1938, set forth references to the Court's decisions in many cases, and said: "A stock dividend does not constitute income if the new shares confer no different rights or interest than did the old—the new certificates plus the old representing the same proportionate interest in the net assets of the corporation as did the old." Three examples followed, the second relating to a dividend identical with the one before us. The example concluded: "The stock so distributed does not constitute a taxable stock dividend to the shareholder." The Treasury also issued a statement of general policy as to stock dividends, to the effect that it would allow a dividends paid credit against the undistributed-profits tax with respect to stock dividends which were clearly taxable to stockholders and refuse such credit with respect to stock dividends which were "clearly nontaxable to the share-

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shall be taxed in the same manner as partners. By reason of the recent decision of the Supreme Court in the stock dividend case (*Eisner* v. *Macomber*, 252 U. S. 189), considerable doubt exists as to the constitutionality of the existing law." See also, S. Rep. No. 275, 67th Cong., 1st Sess., p. 16.

See also, § 220 of the Revenue Acts of 1924 and 1926, 43 Stat. 253, 277; 44 Stat. 9, 34; § 104 of the Revenue Acts of 1928 and 1932, 45 Stat. 791, 814; 47 Stat. 169, 195; and §§ 102 and 351 of the Revenue Acts of 1934, 48 Stat. 679, 702, 751.

The 1926 and subsequent Acts permitted the avoidance of tax on the corporation by inclusion of undistributed corporate income in the gross income of its shareholders.

[31] Thus, Senator Black said on the floor of the Senate that "It is a vain and an illusory hope to anticipate that the Government of the United States will ever be able to prevent tax avoidance on the part of corporate officials by the simple expedient of charging and proving against them that they have withheld a distribution of profits to avoid taxes." 80 Cong. Rec. 8811. See also statement by Oliphant, General Counsel of the Treasury, House Hearings on the Revenue Act, 1936, House Ways and Means Committee, 74th Cong., 2d Sess., pp. 658-659; footnotes 10 and 12, *supra*; cf. Report of Subcommittee of the House Committee on Ways and Means, Tax Revision, 1938, January 14, 1938, 75th Cong., 3d Sess., pp. 20, *et seq.*; H. R. Rep. No. 1860, 75th Cong., 3d Sess., p. 53; 65 Cong. Rec. 8014 *et seq.*; Martin, Taxation of Undistributed Corporate Profits, (1936) 35 Michigan Law Review 44, 50, 62.

holder''; and where taxability was a debatable question, it would tentatively allow a dividends-paid credit if the corporation claiming the credit should file proper waivers or agreements to protect the interests of the Government pending final determination of the taxability to shareholders of the distribution, either by closing agreement executed by all shareholders or by a final adjudication in court.[32]

Administration of § 115(f)(1) was undertaken and continued upon the basis of this construction, and no effort was made to obtain a different one. On the contrary the Government in this Court took the position that the meaning of § 115(f)(1) was correctly stated by Congressman Vinson on the floor of the House as quoted *infra*, pp. 7[illegible].[33]

Other agencies of the Government accepted this same view of the meaning of the statute, authorizing the issuance by corporations subject to their supervision of securities other than common stock, at variance with their usual policy and in order to permit the corporations to do what the Treasury assured them was necessary to avoid the payment of undistributed-profits taxes.[34]

The undistributed-profits tax evoked a voluminous literature, which showed almost universal agreement with the correctness of the Treasury's contemporaneous statement of the meaning of the statute.[35]

We think if Congress had passed or intended to pass an Act challenging a well known constitutional decision of this Court there would at least one clear statement of that purpose appear either from its proponents or its adversaries. Not one contemporaneous word in or out of Congress discloses the purpose which the Government says we should find that this legislation accomplished.

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[32] I. T. 3037, Cum. Bull. 1937-1, p. 90.

[33] See Government's Brief in Helvering v. Gowran, 302 U. S. 238, p. 20 (October, 1937).

[34] The Greyhound Corporation—Issuance of Preference Stock, 1 M. C. C. 357; Mission Oil Co., 1 S. E. C. 940; cf. International Paper & Power Co., 2 S. E. C. 274; Southwestern Development Co., 2 S. E. C. 930.

[35] McLaren, Management of Capital Distributions under the Revenue Act of 1936, (1936) 62 Journal of Accountancy, 334, 354-355; Schulman, Undistributed Profits Tax after the Koshland Case, (1936) 14 Tax Magazine 703, 705; Anderson, The Taxability of Stock Dividends, (1937) 15 Tax Magazine 74, 77; Graham, The Undistributed Profits Tax and the Investor, (1936) 46 Yale Law Journal 1, 6-7; Note (1936) 50 Harvard Law Review 332, 334; cf. Hendricks, The Undistributed Profits Tax, (1936) 46 Yale Law Journal 19, 38-41.

Against this background it was proposed to incorporate an undistributed-profits tax in the pending Revenue Act for 1938. As proposed and enacted, § 115(f)(1) was the same as in the 1936 Act.[36] Like earlier Acts, the Revenue Act of 1938, as proposed and enacted, contained provisions intended to conform with the authority of *Eisner* v. *Macomber*,[37] and it was attacked as em-

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In an article published in April of 1940, Surrey, Assistant Legislative Counsel of the Treasury Department, later advanced the contrary view. The Supreme Court and the Federal Income Tax, 35 Illinois Law Review 779, 794.

[36] § 115(f)(1), H. R. 9682, 75th Cong., 3d Sess.; 52 Stat. 447, 497.

[37] § 102, 52 Stat. 447, 483; § 401, 52 Stat. 447, 557 (similar to § 351 of the Revenue Act of 1936). The Revenue Act of 1938, as proposed and enacted, contained a "consent dividends" provision allowing shareholders to permit the corporation to avoid the undistributed profits tax by consenting to include in their returns amounts as though actual distributions had been made in cash. § 28, 52 Stat. 447, 470-472. See Report of Subcommittee of the House Committee on Ways and Means, on Proposed Revision of the Revenue Laws, 75th Cong., 3d Sess., Jan. 14, 1938, pp. 18-20; H. R. Rep. No. 1860, 75th Cong., 3d Sess., pp. 24 *et seq.*

The following colloquy between Alvord, representing the Committee of Federal Finance, Chamber of Commerce of the United States, and Congressman Lewis, took place at the House Hearings. Hearings on the Revenue Act, 1938, House Ways and Means Committee, pp. 505-506:

Mr. Lewis. Do you realize that these extra taxes on the corporations as such, including the personal holding company and the others, are due to the decision in *Eisner* v. *Macomber*?

Mr. Alvord. Yes.

Mr. Lewis. I am just asking that by way of preface.

Mr. Alvord. Yes, sir. I discussed that quite at length, I think, back in 1936.

Mr. Lewis. Unhappily, it is not being discussed at the present time in the press as fully as it should be in order that the procedure of the committee be fairly understood. You will recall, of course, that under that decision, a 5-to-4 decision, it was held that, notwithstanding the general terms of the income-tax amendment, that tax on paid-up stock dividends was unconstitutional.

Now, before I go any further, I want to say that certainly so far as I am concerned there would be no support for any of these extra taxes if that decision were reversed and the earned income of shareholders in corporations were left subject to taxation, just as the earned income of partners is subject to tax, although that income may be plowed into the parnership business.

Mr. Alvord. I think if you will read my testimony back in 1936 you will find that I agree with you absolutely in principle. But bear in mind that we have some very practical problems in addition to consider.

Mr. Lewis. Very well.

Mr. Alvord. Because I do not think you can afford to exempt the corporation entirely for example, which the following of that decision would require.

Mr. Lewis. Now, of course, the general public wants to be fair in this matter, and even your clients realize that the Government of the United States must in some way secure revenues. I am a little curious to know why voices as influential as yours, or especially as the voice of your clients—I read all their reports, profit by them, I am glad to say—have never been raised asking a reversal of that decision so that we can go back and tax shareholders normally as we do other individuals and partners.

All this trouble we are discussing today will disappear in a moment if that result is obtained.

Mr. Alvord. I think, Mr. Lewis, I can explain to you fully why that has

bodying the principle of forcing the distribution of needed corporate assets. The rate of the undistributed-profits tax was, however, very materially lower than in the 1936 Act.[38] This would have had the effect of diminishing the amount which would be

not been done up to the present time. If I recall correctly, *Eisner* v. *Macomber* was decided in the late spring of 1921, just while the 1921 act was under consideration, just before it passed; whereupon a specific provision was written into the statute, saying that stock dividends escape taxes; and that provision has stayed in the statute.

Mr. Lewis. Yes.

Mr. Alvord. It has been whittled down, it is true.

Mr. Lewis. Yes. But the decision also carries a provision against taxing even undistributed income to the shareholder.

Mr. Alvord. No; I do not think that is true, Mr. Lewis.

Mr. Lewis. Well, that is the view of others, and that is the view of the committee. If you will provide me a way by which the shareholder in the corporation can be required to pay his taxes like individuals and partners on earned income, I will promise you my support in an effort to repeal all these extra tax provisions.

Mr. Alvord. Well, I think your posit on is almost unassailable in that respect, Mr. Lewis.

Mr. Lewis. Very well.

Mr. Alvord. It is a position that many of us have taken for a long time.

Mr. Lewis. But will you hear this question in the spirit it is put: Do you not think the Government under such circumstances is under a duty to try in some way to recoup itself for these lost taxes in the shareholder group who would be subject to them? If we are, isn't it natural that we should go to the corporation that is shielding them, in most cases, of course, unintentionally, but still go to the corporation and say: "Now please distribute those dividends so that we can get at this shareholder who is dodging his burden under *Eisner* v. *Macomber*"? Isn't that all very natural, sir?

Title II of the Revenue Act of 1937 amended the Revenue Act of 1936 by adding § 334, which provided for the inclusion in the gross income of shareholders in foreign personal holding companies the undistributed corporate income. The abuses incident to the employment of this device had been brought out at Hearings before a Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess. The Committee Reports on the Bill cite the practical necessity for this form of tax in support of its constitutionality. H. R. Rep. No. 1546, 75th Cong., 1st Sess., pp. 13-14; Sen. Rep. No. 1242, 75th Cong., 1st Sess., pp. 15-16; Report of the Joint Committee on Tax Evasion and Avoidance, House Doc. No. 337, 75th Cong., 1st Sess., pp. 16-19. See statement of Congressman Vinson on the floor of the House, 81 Cong. Rec. 9035: "The philosophy in regard to foreign personal holding companies is based upon the inherent power in the Government to protect itself from devices to avoid and evade its law. The Supreme Court has said that the Congress has the power to regulate interstate rates, and that it can regulate intrastate rates when such exercise of power is to protect the plenary power over interstate rates. We feel certain that the jurisdiction over American taxpayers and income to our citizens, together with the power to protect our revenues are ample legal support for our position." See also, statement of Congressman Treadway, 81 Cong. Rec. 9024.

The foreign personal holding company tax was retained in the Revenue Act for 1938. 52 Stat. 447, 545, *et seq.*

[38] See Report of Subcommittee of the House Committee on Ways and Means, 75th Cong., 3d Sess., pp. 2 *et seq.*; H. R. Rep. No. 1860, 75th Cong., 3d Sess., pp. 4-6; Sen. Rep. No. 1567, 75th Cong., 3d Sess., pp. 2-5; H. R. Rep. No. 2330, 75th Cong., 3d Sess., pp. 1 *et seq.*, 23.

collected from the corporation as undistributed-profits tax despite the declaration of a nontaxable stock dividend. Despite these factors, again there was not the slightest suggestion of the view that § 115(f)(1) had made or had intended to make all stock dividends taxable; on the contrary there was continued recognition of the authority of *Eisner* v. *Macomber*.[39] Section 115(f)-(1) was reenacted while the Treasury Regulation and rulings on its meaning stood unamended and in their original form.[40]

The Treasury adhered to its earlier views of the meaning of § 115(f)(1) by repromulgating its former Regulation under the Revenue Act of 1938 and under the Internal Revenue Code,[41] and it stood unamended at the time of the receipt of the stock dividends here in question. Congress in 1939 enacted basis provisions incorporating the language of § 115(f)(1).[42] It was not until November 15, 1940, and after the receipt of the dividends here involved, that the Treasury amended the Regulation, and then only by striking out all after the first sentence.[43] This action followed the decision of this Court in *Helvering* v. *Brunn*, 309 U. S. 461, on March 25, 1940, which rejected the concept that taxable gain could arise only when the taxpayer was able to sever increment from his original capital. It preceded by ten days the decision in *Helvering* v. *Horst*, 311 U. S. 112, which held that there was no exemption from taxation where economic gain is enjoyed "by some event other than the taxpayer's personal receipt of property or money." *Id.* at 116. Each of these decisions undermined further the original theoretical bases of the decision in *Eisner* v. *Macomber*.

The Government says that the time has come when *Eisner* v. *Macomber* must be overruled, and that we should construe § 115(f)(1) as intended to tax the dividends here in question and thus to require reconsideration of that decision. It should be

[39] See statement of Congressman Vinson of Kentucky on the floor of the House, 83 Cong. Rec. 2780, and colloquy set forth in footnote 37, *supra*.

[40] 52 Stat. 447, 497.

[41] Article 115-7 of Regulations 101; § 19.115-7 of Regulations 103.

[42] § 214 of the Revenue Act of 1939, 53 Stat. 862, 872.

[43] T. D. 5020, C. B. 1940-2, p. 118, amending § 19.115-7 of Regulations 103, promulgated under the Internal Revenue Code.

Amendment of Regulations 101 and 94 did not come until January 19, 1942, by T. D. 5110, Cum. Bull. 1942-1, p. 160.

As amended, the Regulation read: "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution."

observed that the question of the constitutional validity of *Eisner* v. *Macomber* is plainly one of the first magnitude, but this is not to say that it is presented in this case. Under our judicial tradition we do not decide whether a tax may constitutionally be laid until we find that Congress has laid it. Unless the tax asserted by the Commissioner has been authorized by Congress it fails of validity before we even reach the constitutional question. To reach that question we must decide whether Congress intended by § 115(f)(1) to do what *Eisner* v. *Macomber* squarely held that it could not. We cannot find that it did.

The Government cannot sustain its position on a literal reading of § 115(f)(1). Unlike the Revenue Act of 1916,[44] it does not state that all stock dividends are taxable. Instead, § 115(f)(1) qualifies the generality of § 22(a) by providing that a distribution made in shares of the corporation's stock "shall not be treated as a dividend to the extent that it *does* not constitute income to the shareholder within the meaning of the Sixteenth Amendment. . . ." [Italics supplied.] If the statute is to be literally read, use of "does" instead of some word of futurity indicates that the time of enactment or at the latest the time of receipt of the dividend is the critical one for determining taxability. Under either view these dividends would not be taxable. The parties are agreed that for the purposes of this decision the meaning of the Constitution must be found in the decisions of this Court, and when these dividends were received *Eisner* v. *Macomber* fixed the meaning contrary to the Government's position.

The administrative and legislative history of the statute squarely conflict with the Government's position in this case.

The Treasury Regulation issued under § 115(f)(1) immediately after it was first enacted states in terms that the statute was not intended to lay a tax on the facts of this case and of *Eisner* v. *Macomber*, and the Treasury advised taxpayers by another ruling that some stock dividends were "clearly" nontaxable. In *White* v. *Winchester Club*, 315 U. S. 32, 41, we said that such "substantially contemporaneous expressions of opinion are highly relevant and material evidence of the probable general understanding of the times and of the opinions of men who probably were active in the drafting of the statute."[45] The statute was reenacted in its original

[44] See note 3, *supra*.

[45] See also, Edward's Lessee v. Darby, 12 Wheat. 206, 210; United States v. Moore, 95 U. S. 760, 763; Fawcus Machine Co. v. United States, 282 U. S. 375, 378; Norwegian Nitrogen Co. v. United States, 288 U. S. 294, 315.

form after having been in force for two years, and after a long controversy centering around the meaning of the statute which assumed throughout the correctness of the administrative construction. This Court has denied retroactive effects to amendments to valid Treasury Regulations which have survived reenactment of the statute, even in the absence of any affirmative indication that the subject-matter of the statute and Regulation was called to the attention of Congress.[46] The effect of reenactment in the absence of such affirmative indications of agreement has been stated in various and not entirely consistent terms.[47] This is a question we do not now need to examine, for there are in this case many indications that Congress was in complete agreement with the

[46] Helvering v. R. J. Reynolds Tobacco Co., 306 U. S. 110; cf. Helvering v. Wilshire Oil Co., 308 U. S. 90; Helvering v. Reynolds, 313 U. S. 428; White v. Winchester Club, *supra*.

The problems in this field have evoked extensive commentary. Paul, Use and Abuse of Tax Regulations in Statutory Construction, 49 Yale Law Journal 660, reprinted with some changes in Paul, Studies in Federal Taxation, Third Series, (1940) 420; Alvord, Treasury Regulations and the Wilshire Oil Case, 40 Columbia Law Review 252; Surrey, The Scope and Effect of Treasury Regulations under the Income, Estate and Gift Taxes, 88 University of Pennsylvania Law Review 556; Brown, Regulations, Reenactment, and the Revenue Acts, 54 Harvard Law Review 377; Griswold, A Summary of the Regulations Problem, 54 Harvard Law Review 398; Feller, Addendum to the Regulations Problem, 54 Harvard Law Review 1311.

[47] Helvering v. Winmill, 305 U. S. 79, 83: "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." In Helvering v. R. J. Reynolds Tobacco Co., 306 U. S. 110, 116, it was said that: "Since the legislative approval of existing regulations by reenactment of the statutory provision to which they appertain gives such regulations the force of law, we think that Congress did not intend to authorize the Treasury to repeal the rule of law that existed during the period for which the tax is imposed," and the question of the validity of prospective amendment was left open. In Helvering v. Wilshire Oil Co., 308 U. S. 90, the Court carefully examined the taxpayer's position for equities and found it wanting; and after citing the Reynolds Tobacco case with approval, stated with reference to the view that reenactment of a statute carried legislative approval of its existing valid administrative construction, that: "It does not mean that a regulation interpreting a provision of one act becomes frozen into another act merely by reenactment of that provision, so that administrative interpretation cannot be changed prospectively through exercise of appropriate rule-making powers." *Id.* at 100. Helvering v. Reynolds, 313 U. S. 428, qualified the Reynolds Tobacco case and distinguished it on the ground that "The transactions there in question took place at a time when a regulation was in force which expressly negatived any tax liability. The regulation remained outstanding for a long time and was followed by several reenactments of the statute. About five years after the transaction in question took place, the prior regulation was amended so as to impose a tax liability. There are no such circumstances here." *Id.* at 432-433.

Treasury on the question of the taxability of the stock dividends here involved. We would think it unquestionable that in this case the Treasury could not retroactively amend the Regulation to the prejudice of the respondent except for the Government's assertion that it should be disregarded upon the authority of *Helvering* v. *Hallock*, 309 U. S. 106, 121, note 8, and that in any event under § 3791(b) of the Internal Revenue Code the Secretary or Commissioner must be held to have authority in any case to make a retroactive amendment of a Regulation.

The *Hallock* case is clearly inapposite. There it was held that Treasury Regulations issued more than 11 years after the enactment of the Revenue Act of 1926,[48] in submission to the decision of this Court in 1935 of the *St. Louis Trust Co.* cases, 296 U. S. 39, 48, could not prevent the Court from overruling those cases on facts entirely antedating them. That Regulation did not purport to construe the meaning of the statute, as did this one, but simply to acknowledge a constitutional limit imposed by this Court upon the operation of a previously enacted statute; it was not in effect when the transactions involved were entered upon; and there had been no reenactment of the statute while the Regulation was in force.

Nor do we concur in the Government's argument that the legislative history of § 3791(b) of the Internal Revenue Code requires reconsideration of our decision as to the effect of a corresponding provision of the Revenue Act of 1928 in *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110, 116.[49] We think that in the circumstances of this case the administrative construction in effect at the time of the receipt of the stock dividends here in issue must be given controlling effect.

We would be reluctant in any event to find that Congress intended to hold the effect of § 115(f)(1) in abeyance until the

[48] T. D. 4729, Cum. Bull. 1937-1, p. 284.

[49] Section 3791(b) of the Internal Revenue Code provides that: "The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect."

This provision has been in its present form since § 506 of the Revenue Act of 1934, 48 Stat. 680, 757, amended § 1108(a) of the Revenue Act of 1926. It is the final statute of a series intended to relieve the Treasury from the effect of the view that its administrative rulings, like court decisions, must have retroactive as well as prospective operation.

During and after the first World War the Treasury had been burdened with a great volume of tax business. Perfect consistency in rulings was impossible, and the view that each change in administrative construction must be given

Treasury should decide that the time was ripe to challenge *Eisner* v. *Macomber* and carry its challenge to this Court. Such an intention would be a serious departure from the usual policy of Congress to provide the taxpayers and tax-gatherers with a practical basis for the timely settlement of questions of taxation arising each year. At the times of enactment the problem of delay in obtaining decisions of this Court was a matter of grave concern to those concerned with the administration and furnishing of the revenues.[20]

The Government's assertion that Congress intended to hold the meaning of § 115(*f*)(1) in suspense until the termination of years of litigation is in conflict with our recent decision in *Parker* v. *Motor Boat Sales Co.*, 314 U. S. 244. There we were called upon to construe § 3(a) of the Longshoremen's and Harbor Workers' Act, 44

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retroactive effect deprived both the Government and the taxpayers of any assurance that cases once settled would stay settled. See statement by Dr. Adams, Tax Adviser to the Treasury, Hearings, Revenue Revision, House Ways and Means Committee, 67th Cong., 3d Sess., pp. 38-40; H. R. Rep. No. 1035, 66th Cong., 2d Sess., p. 3.

To remedy this situation Congress provided in § 1314 of the Revenue Act of 1921, 42 Stat. 227, 314, that: "in case a regulation or Treasury decision" should be reversed by a subsequent "regulation or Treasury decision, and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction," the subsequent regulation or decision might be applied without retroactive effect. This provision was carried into the Revenue Acts of 1924 and 1926. 43 Stat. 253, 340; 44 Stat. 9, 114. The 1928 Act expanded it to include cases where the new Regulation or Treasury decision was occasioned or required by a court decision. 45 Stat. 791, 874; S. Rep. No. 960, 70th Cong., 1st Sess., p. 40. The Conference Committee stated that: "It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decision, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely." H. R. Rep. No. 1882, 70th Cong., 1st Sess., p. 22.

The Committee Reports state that § 506 of the Revenue Act of 1934, now § 3791(b) of the Internal Revenue Code, was intended to permit the Treasury to avoid inequities to persons who had closed transactions in reliance upon "existing practice," and that the "amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury Decisions amending prior regulations or Treasury Decisions prospective effect only by allowing the Secretary, or the Commissioner, with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury Decision, *whether or not it amends a prior regulation or Treasury Decision*, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect." [Italics supplied.] H. R. Rep. No. 704, 73d Cong., 2d Sess., p. 38; S. Rep. No. 558, 73d Cong., 2d Sess., p. 48.

Thus it appears that this legislation was intended to permit escape from the retroactive effects of administrative action by the Treasury, rather than to increase its power to make retroactive rulings. Cf. 69 Cong. Rec. 7881.

[20] Traynor, Administrative and Judicial Procedure for Federal Income, Estate, and Gift Taxes, 38 Columbia Law Review 1393.

Stat. 1424, which made compensation payable only if "recovery for the disability or death through workmen's compensation may not validly be provided by State law." Its statement in such terms was due to this Court's decision in *Southern Pacific Co.* v. *Jensen*, 244 U. S. 205, a much criticized and somewhat impaired, but not overruled, decision which held federal power exclusive and state compensation laws forbidden in an area of "shadowy limits." The Court, speaking through Mr. Justice Black, said, "An interpretation which would enlarge or contract the effect of the proviso in accordance with whether this Court rejected or reaffirmed the constitutional basis of the *Jensen* and its companion cases cannot be acceptable. The result of such an interpretation would be to subject the scope of protection that Congress wished to provide, to uncertainties that Congress wished to avoid." *Id.* at 248, 250.

The Government urges that we read into the Congressional Act an intent to tax these dividends because of considerations that we do not think are entitled to any weight. It argues that the form of § 115(f)(1) is attributable to "embarrassment" which would have been incident to a "frontal attack" on *Eisner* v. *Macomber*. There is ample ground to know that the prospect of conflict in opinion with this Court on constitutional questions was not sufficient so to mute the 74th and 75th Congresses.[51] This was as it should be. There is no reason to doubt that this Court may fall into error as may other branches of the Government. Nothing in the history or attitude of this Court should give rise to legislative embarrassment if in the performance of its duty a legislative body feels impelled to enact laws which may require the Court to re-examine its previous judgments or doctrine.[52] The Court differs, however, from other branches of the Government in its ability to extricate itself from error. It can reconsider a matter only when it is again properly brought before

[51] Thus, the Congress which first enacted § 115(f)(1) also substantially reenacted provisions of the Municipal Bankruptcy Act held unconstitutional in Ashton v. Cameron County District, 298 U. S. 513. It did so after Chairman Sumners of the Judiciary Committee in charge of the Bill frankly stated on the floor of the Senate that it implied certain proceedings which would be unconstitutional under that decision. He went on to say, however, that it was not only the right but the duty of Congress to present this question once more to the Court, since the decision if allowed to stand had certain consequences which he described and deplored. This history was called to the attention of the Court, and the Act was sustained. United States v. Bekins, 304 U. S. 27, 33.

[52] Thus, O'Malley v. Woodrough, 307 U. S. 277, overruled Miles v. Graham, 268 U. S. 501, as to the constitutionality of taxation of salaries of federal

it in a case or controversy; and if the case requires, as a tax case does,[53] a statutory basis for a case, the new case must have sufficient statutory support.

And, if we were to assume Congressional "embarrassment" and take it into consideration, we would also be required to weigh the many other political factors which may have motivated the choice employed in the language of § 115(f)(1). Those in favor of the Bill may have believed that the adoption of existing decisions was the most that was politically possible; those who opposed it may have thought it desirable as matter of tax policy to defer taxation of the stock dividend until realization.[54] Needless to say, speculation upon such factors has no place in the construction of Acts of Congress.

We are asked to make a retroactive holding that for some seven years past a multitude of transactions have been taxable although there was no source of law from which the most cautious taxpayer

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judges; United States v. Darby, 312 U. S. 100, overruled Hammer v. Dagenhart, 247 U. S. 251, as to Congressional power over labor in manufacture; West Coast Hotel Co. v. Parrish, 300 U. S. 379, overruled Adkins v. Children's Hospital, 261 U. S. 525, and Morehead v. Tipaldo, 298 U. S. 587, as to power to enact minimum wage laws. Compare also Wright v. Vinton Branch, 300 U. S. 440, with Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, as to farmer bankruptcy statutes; Labor Board v. Jones & Laughlin, 301 U. S. 1, with Schechter Corp. v. United States, 295 U. S. 495, as to commerce power; and United States v. Darby, *supra*, and Sunshine Anthracite Coal Co., 310 U. S. 381, with Carter v. Carter Coal Co., 298 U. S. 238, as to commerce power. See also, cases cited by Mr. Justice Brandeis in Burnet v. Coronado Oil & Gas Co., 285 U. S. 393, 406-408, notes 1 and 2.

[53] Article I, § 8, cl. 1, of the Constitution provides that "The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States . . . ." Article I, § 7, cl. 1, provides that "All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills."

[54] The considerations which underlay the decisions in Towne v. Eisner and Eisner v. Macomber may have had their influence in the judgment of Congress itself. Compare the question put by Senator Bone to Senator Black set forth, *supra*, p. 19. Before the decision in Eisner v. Macomber the Supreme Judicial Court of Massachusetts had held that stock dividends could be taxed, Tax Commissioners v. Putnam, 227 Mass. 522 (1917); but the Massachusetts legislature had also specifically exempted them from income taxation. Mass. Stat. 1920, c. 352, now G. L. c. 62 § 1(b). After the decision of Eisner v. Macomber the Supreme Court of Wisconsin rejected its reasoning in State ex rel. Dulaney v. Nygaard, 174 Wis. 579 (1921), but since 1927 stock dividends have been exempted from income taxation. Wis. Stat. c. 71.02. In 1926 the New York legislature adopted a provision retroactive to January 1, 1919, the effective date of the first state income-tax law, exempting all stock dividends. See People ex rel. Clark v. Gilchrist, 243 N. Y. 173.

could have learned of the liability. If he consulted the decisions of this Court, he learned that no such tax could be imposed; if he read the Delphic language of the Act in connection with existing decisions, it, too, assured him there was no intent to tax; if he followed the Congressional proceedings and debates, his understanding of nontaxability would be confirmed; if he asked the tax collector himself, he was bound by the Regulations of the Treasury to advise that no such liability existed. It would be a pity if taxpayers could not rely on this concurrent assurance from all three branches of the Government. But we are asked to brush all this aside and simply to decree that these transactions are taxable anyway.

Nor is the effect on taxpayers the only consequence of accepting such a proposal. It would unsettle tax administration and subject the Treasury itself to many demands in ways that we cannot anticipate and provide for. Many have sold dividend stocks and paid the postponed tax at higher rates than if they had been taxed as is now proposed. Many have paid on the sale of the original stock because of allocation of part of the dividend to reduce the cost base thereof. Many corporations have been refused deductions on account of this type of stock dividend in computing their undistributed corporate earnings tax, which would become entitled to them. Overhanging the whole effort to accommodate these past transactions to a new retroactive law would be the statute of limitations barring sometimes the Government and sometimes the taxpayer with capricious effects. To rip out of the past seven years of tax administration a principle of law on which both Government and taxpayers have acted would produce readjustments and litigation so extensive we would contemplate them with anxiety. We have recently held as to another questioned decision of this Court that a long period of accommodations to an older decision sometimes requires us to adhere to an unsatisfactory rule to avoid unfortunate practical results from a change. *Davis* v. *Department of Labor* (No. 86, October Term, 1942, decided Dec. 14, 1942). We think this another example of the same principle.

The Government acknowledges the hardship which would be incident to the rule we are now asked to declare, and promises its assistance in obtaining legislative correction. It says that: "We are informed by the Treasury that it has no intention of harassing taxpayers with respect to liability for past years, and that if *Eisner*

v. *Macomber* is overruled it intends immediately to recommend to Congress legislation which would relieve taxpayers of any unfair retroactive burden that might result from such overruling. . . ."

Of course, if there were an adequate basis in statute and regulation for the tax in question, it is difficult to understand why its collection should be regarded as "harassing." This assurance that if we will but find that Congress has intended to lay the tax it will be asked to declare that it does not intend it to be collected is hardly reassuring that the decision contended for would be what Congress intended. Since it is acknowledged that legislation would be required to adjust equities that are beyond judicial power and to prevent our decision's being used to harass taxpayers, we may well inquire why the legislation should not precede the judicial decision. Why should we be asked to impose by interpretation a tax which the Treasury intends to ask Congress to lift?

We are unable to find that Congress intended to tax the dividends in question, and without Congressional authority we are powerless to do so. That being the case, we cannot reach the reconsideration of *Eisner* v. *Macomber* on the basis of the present legislation and Regulations.

The decision below is

Affirmed.

Mr. Justice RUTLEDGE did not participate in the consideration or decision of this case.

SUPREME COURT OF THE UNITED STATES.

No. 467.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Sylvie R. Griffiths. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[March 1, 1943.]

Mr. Justice Douglas, dissenting.

Eisner v. *Macomber* dies a slow death. It now has a new reprieve granted under circumstances which compel my dissent.

I.

In 1936 Congress provided that stock dividends were taxable as income when they constituted "income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."[1] § 115(f)(1). That statutory provision is now rewritten so as to permit stock dividends to be taxable when they constitute "income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution as construed by *Eisner* v. *Macomber*." That extraordinary result is reached in the face of the plain language of the Act and in face of clear statements of its purpose made in Committee Reports. The report of the House Ways and Means Committee (H. Rep. No. 2475, 74th Cong., 2d Sess., p. 10) stated

[1] Sec. 115(a) defines "dividend" as follows: "The term 'dividend' when used in this title . . . means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

Sec. 115(f)(1) is entitled "General Rule" and reads as follows: "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution."

Sec. 115(j) sets forth the formula for valuation of dividends other than cash dividends: "If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder."

that stock dividends were to be taxable when they constituted "income to the shareholder within the meaning of the sixteenth amendment to the Constitution." The report of the Senate Finance Committee (S. Rep. No. 2156, 74th Cong., 2d Sess., p. 18) contained the unequivocal statement that "stock dividends are made taxable *to the full extent permitted by the Constitution.*" That purpose is now thwarted. Reliance is placed on certain statements made by Mr. Vinson who managed the bill on the floor of the House. Yet the most that can be said is that his statements in explanation of the bill were ambiguous. He stated, to be sure, that the new provision was not to be regarded "as an attack upon the Eisner against Macomber decision." 80 Cong. Rec., Pt. 6, p. 6215. But in answer to an inquiry from Mr. Treadway whether the new provision "describes new stock dividends that can be taxed or what portion of stock dividends under the sixteenth amendment can in the future be taxed," he made the following statement: "Well, we take the broad position that stock dividends that are taxable income within the sixteenth amendment are subject to taxation, and if they are not such stock dividends and not any taxable income under the sixteenth amendment, they are not subject to taxes." *Id.*, p. 6310. I fail to see in that declaration even any intimation that *Eisner* v. *Macomber* rather than the Constitution marked the reach of the new legislation. Furthermore, a reading of the whole discussion on the floor of the House indicates to me that his denial that the legislation made an "attack" on *Eisner* v. *Macomber* fell far short of suggesting that the House intended to *foreclose* this Court from reexamining *Eisner* v. *Macomber*. If Congress had that purpose, the Act hardly would have been phrased in terms which embrace the full scope of the Sixteenth Amendment. To me the disavowal of an intent to "attack" *Eisner* v. *Macomber* meant no more than a disclaimer of any purpose to propose unconstitutional legislation. *Eisner* v. *Macomber* is a decision of this Court. Under the traditional conceptions of the place of judicial review in our constitutional system this Court and only this Court can change the rule of that case in absence of an amendment to the Constitution. Congress here was merely respecting that traditional view. It wanted to go as far as it could. But it could have no idea how far that would be until this Court spoke. No one could predict whether this Court would overrule, modify, or sustain *Eisner* v. *Macomber* when the 1936 legislation came before it. Indeed, when the 1936

bill passed the House,[2] *Koshland* v. *Helvering*, 298 U. S. 441, which narrowed the application of *Eisner* v. *Macomber*, had not been de ided by this Court. And *Helvering* v. *Gowran*, 302 U. S. 238, which somewhat extended the rule of the *Koshland* case was not decided until after the 1936 Act was passed. But numerous decisions by lower courts had made inroads on the *Eisner* v. *Macomber* doctrine. The rule of that case was in flux; a process of erosion had set in; and none knew where that erosion would cease. Accordingly, Congress drafted § 115(f) of the 1936 Act in the most flexible of terms. It used sweeping language incorporating the full coverage of the Sixteenth Amendment so that those stock dividends would be taxed which this Court would permit to be taxed. There are probably other ways in which the same idea could have been phrased. But the one chosen is clear enough.

The only Treasury Regulations applicable to the taxable year in question — 1939 — are Regulations 103. These were originally promulgated on January 29, 1940. Sec. 19.115-7 provided: "A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a dividend to the full extent that it constitutes income to the shareholders within the meaning of the sixteenth amendment to the Constitution." That sentence was followed by the statement, "The Supreme Court has pointed out some of the characteristics distinguishing a stock dividend which constitutes income from one which does not constitute income within the meaning of the Constitution." Then followed a summary of our decisions, ending with three examples based on the *Koshland* case, *Eisner* v. *Macomber*, and the *Gowran* case. On November 15, 1940, this regulation was amended by striking out everything following the first sentence. This regulation, however, even in its original form did not and could not foreclose inquiry into the validity of the decision in *Eisner* v. *Macomber*. It did no more than state the constitutional principles on which the decided cases rested. It certainly did not indicate that the Treasury construed the statute more narrowly than the Constitution itself. However that may be, this Court on more than one occasion has refused to follow a Treasury regulation which it felt to be "in the teeth" of the statute. *Helvering* v. *Sabine Transportation Co.*, No. 518, decided March 1, 1943; *Helvering* v. *Credit*

[2] April 29, 1936. See 80 Cong. Rec., p. 6367. The Koshland case was decided by this Court on May 18, 1936.

Alliance Corp., 316 U. S. 107. If this regulation be construed to narrow the Act so as to tax only stock dividends permitted by *Eisner* v. *Macomber*, I would have less reluctance in striking it down than I have had in other instances.

But there is said to be lack of wisdom in this interpretation of the Act. It is argued that it would be disruptive of tax administration. It is urged that a decision which now overruled *Eisner* v. *Macomber* would be unfair because it would be retroactive. Those matters are none of our business. Every revenue act which Congress has passed has a retroactive effect. It is something on which taxpayers of necessity take their chances. *Milliken* v. *United States*, 283 U. S. 15, 23. And many of the uncertainties in revenue acts necessarily are not resolved until this Court passes on them years later. Here there is no possible basis for complaint. These stock dividends were declared in 1939, three years after the Act making them taxable was passed. Of course, the taxpayer no more than Congress could predict what interpretation this Court would give the new statute. Sec. 115(f)(1), however, made the risks apparent. The fact that some guessed wrong is wholly irrelevant to this litigation. Inequities may result from a holding in 1943 that *Eisner* v. *Macomber* has not been the law since 1936. But the relief against them lies with Congress. Our task ends if we erase *Eisner* v. *Macomber* and give Congress a clean slate on which to write. Then and only then can Congress design a tax system treating stock dividends consistently. So long as Congress has to guess whether or not this Court will overrule *Eisner* v. *Macomber*, any interim treatment which it gives stock dividends may have to be readjusted after this Court speaks so as to remove inequities which may have resulted.

II.

I think *Eisner* v. *Macomber* should be overruled. The Sixteenth Amendment gives Congress the power "to lay and collect taxes on incomes, from whatever source derived". As Mr. Justice Brandeis stated in his dissent in *Eisner* v. *Macomber*, 252 U. S. p. 237, that Amendment was designed to include "everything which by reasonable understanding can fairly be regarded as income." Stock dividends representing profits certainly are income in the popular sense. "From a practical common-sense point of view there is something strange in the idea that a man may indefinitely grow richer without ever being subject to an

income tax." Powell, *Income From Corporate Dividends*, 35 Harv. L. Rev. 363, 376. The wealth of stockholders normally increases as a result of the earnings of the corporation in which they hold shares. I see no reason why Congress could not treat that increase in wealth as "income" to them.[3] See *Collector* v. *Hubbard*, 12 Wall. 1, 18; *Helvering* v. *National Grocery Co.*, 304 U. S. 282, 288; Powell, *The Stock-Dividend Decision and The Corporate Nonentity*, 5 Nat. Tax Assoc. Bull. 201. The notion that there can be no "income" to the stockholders in such a case within the meaning of the Sixteenth Amendment unless the gain is "severed from" capital and made available to the recipient for his "separate use, benefit and disposal" (*Eisner* v. *Macomber*, 256 U. S. pp. 207, 211) will not stand analysis. In cases like *Koshland* v. *Helvering* and *Helvering* v. *Gowran* where stock dividends were held to be taxable as income, both the original investment and the accumulations were retained by the company. Yet those cases hold that stockholders may receive "income" from the operations of their corporation though the corporation makes no distribution of assets to them. And see *United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176; *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536. Other cases make plain that there may be "income" though neither money nor property has been received by the taxpayer. Benefits accruing as the result of the discharge of the taxpayer's indebtedness or obligations constitute familiar examples. *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716; *Douglas* v. *Willcuts*, 296 U. S.

[3] Cf. the income tax of partners. Sec. 182 of the Internal Revenue Code provides: "In computing the net income of each partner, he shall include, whether or not distribution is made to him . . . (c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b)." A partner is chargeable with his allocable share of the partnership earnings even where they could not be distributed to him by reason of local law. Heiner v. Mellon, 304 U. S. 271, 281: "The tax is thus imposed upon the partner's proportionate share of the net income of the partnership, and the fact that it may not be currently distributable, whether by agreement of the parties or by operation of law, is not material." As stated by Mr. Justice Brandeis in his dissent in Eisner v. Macomber, 252 U. S., p. 231: "The stockholder's interest in the property of the corporation differs, not fundamentally but in form only, from the interest of a partner in the property of the firm. There is much authority for the proposition that, under our law, a partnership or joint stock company is just as distinct and palpable an entity in the idea of the law, as distinguished from the individuals composing it, as is a corporation. No reason appears, why Congress, in legislating under a grant of power so comprehensive as that authorizing the levy of an income tax, should be limited by the particular view of the relation of the stockholder to the corporation and its property which may, in the absence of legislation, have been taken by this court."

1; *United States* v. *Hendler,* 303 U. S. 564. And increase in the value of property as a result of improvements made by the lessee are taxable income to the lessor even though the taxpayer could not "sever the improvement begetting the gain from his original capital." *Helvering* v. *Bruun,* 309 U. S. 461, 469. The declaration of a stock dividend normally will not increase the wealth of the stockholders. Its accrual will usually antedate that event. See Haig et al., The Federal Income Tax (1921) p. 8. For it is the accumulation of corporate earnings over a period of time which marks any real accrual of wealth to the stockholders. The narrow question here is whether Congress has the power to make the receipt of a stock dividend based on earnings an occasion for recognizing that accrual of wealth for income tax purposes. Congress has done so through the formula of computing the "income" to the stockholders at the "fair market value" of the stock dividends received. Sec. 115(j). Whether that is the most appropriate procedure which could be selected for the purpose may be arguable. But I can see no constitutional reason for saying that Congress cannot make that choice if it so desires. That is one way—though perhaps at times a crude one—of measuring for income tax purposes the wealth which normally accrues to stockholders as a result of the earning of their corporation.

Mr. Justice BLACK and Mr. Justice MURPHY join in this dissent.